

UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD

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PETITION FOR RULEMAKING TO ADOPT REVISED
COMPETITIVE SWITCHING RULES

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DOCKET NO. EP 711

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Tuesday,
March 25, 2014

Surface Transportation Board
Suite 120
395 E Street, S.W.
Washington, D.C.

The above-entitled matter came on
for public hearing, pursuant to notice, at
9:30 a.m.

BEFORE:

DANIEL R. ELLIOTT, III, Chairman

ANN D. BEGEMAN, Vice Chairman

PANEL I:

US DEPARTMENT OF TRANSPORTATION
SCOTT GREENE
RAQUEL HUNT
CHRISTOPHER PERRY

PANEL II:

NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE
BRUCE CARLTON
KARYN BOOTH
NICK DiMICHAEL
JAY ROMAN
WALTER SCHUCHMANN

PANEL III:

ASSOCIATION OF AMERICAN RAILROADS
MICHAEL R. BARANOWSKI
WILLIAM J. RENNICKE
B. KELLY EAKIN
PHIL C. IRELAND
SAMUEL M. SIPE, JR.

AMERICAN SHORT LINE & REGIONAL RAILROAD
ASSOCIATION
RICHARD F. TIMMONS

PANEL IV:

ARKANSAS ELECTRIC COOPERATIVE CORPORATION
ERIC VON SALZEN
MICHAEL A. NELSON

INTERESTED AGRICULTURAL PARTIES:

SHARON CLARK

JOINT COAL SHIPPERS

CHRISTOPHER A. MILLS

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1 P-R-O-C-E-E-D-I-N-G-S

2 9:30 a.m.

3 CHAIRMAN ELLIOTT: Good morning,
4 everyone. Today, we begin a two-day public
5 hearing to consider proposals submitted by the
6 National Industrial Transportation League to
7 increase rail-to-rail competition.

8 We held a hearing in 2011 to
9 consider the state of competition in the
10 railroad industry and what steps, if any, we
11 should take to increase rail-to-rail
12 competition.

13 Some of the testimony at that
14 hearing focused on our authority to direct
15 switching and asked us to modify our mandatory
16 reciprocal switching standards.

17 The Board has statutory authority
18 to compel a railroad to enter into a switching
19 agreement, where it finds such agreements to
20 be practical and in the public interest, or
21 where such agreements are necessary to provide
22 competitive rail service.

1 After the hearing, NITL submitted
2 its proposal, which addresses these mandatory
3 reciprocal switching standards.

4 Under the proposal, certain
5 shippers located in terminal areas that lack
6 competitive transportation alternatives would
7 be granted access to a competing railroad, if
8 there is a working interchange within 30
9 miles.

10 We started this proceeding to
11 gather empirical information about the impact
12 of NITL's proposal. We have received many
13 comments in response to our decision, and I
14 want to thank everyone who has participated.

15 These comments have raised a
16 number of important issues relating to the
17 proposal, such as: whether to apply a
18 threshold presumption regarding available
19 competition, such as an R/VC ratio, as
20 proposed by NITL; the distance from a shipper
21 facility within which the proposal would apply
22 and whether the distance is in rail miles or

1 within a radius; and the operational
2 feasibility of the proposed changes.

3 The hearing that begins today will
4 allow us to further explore these issues, the
5 specifics of NITL's proposal and its possible
6 effects.

7 Before we begin, let me just take
8 a few minutes to review a few procedural
9 points about today's hearing.

10 We have two full days of testimony
11 scheduled. We ask all witnesses to please
12 summarize their oral statements in the
13 interest of time. We have read your
14 statements and you should not feel obligated
15 to use every second of the time allotted.

16 Consistent with our practice, we
17 will allow the witnesses on each panel to make
18 full presentations before the members ask any
19 questions. You will have a light before you
20 at the front of the room. One minute before
21 your allotted time has expired, a yellow light
22 will appear. When you see the red light, your

1 time has expired. Please conclude your
2 thought at that point.

3 After the conclusion of the
4 witnesses' presentations, we will rotate
5 between the members, asking questions. If you
6 are scheduled to testify, please make sure
7 that you check in with the clerk at the front
8 of the room.

9 I have also been asked to remind
10 witnesses to please speak clearly into the
11 microphone.

12 In addition, the public should be
13 aware that a video archive of the entire
14 hearing will be placed on the STB website
15 within a few days of the close of the hearing.

16 In the unlikely event that we have
17 a fire alarm or other event requiring
18 evacuation, please proceed in an orderly
19 fashion out of the double doors at the back of
20 the hearing room and out of the building
21 through the front entrance.

22 Specific instructions have been

1 posted at the back of the hearing room for
2 assembly and notification of return, if any,
3 to the hearing room, following any evacuation.

4 Also, a note regarding PowerPoint
5 presentations:

6 If you haven't done so, within the
7 next two days, please provide two hard copies
8 of the PowerPoint presentation to the Office
9 of Proceedings.

10 Finally, if you have not done so
11 already, please turn off your cell phones.

12 With that, I'll turn it over to
13 Vice Chairman Begeman.

14 VICE CHAIRMAN BEGEMAN: Thank you.
15 I want to thank everyone who will be
16 testifying over the next two days. We
17 certainly value your input.

18 I want to also start by commending
19 NITL for putting this proposal forward. It's
20 designed to provide some competitive service
21 options for some shippers.

22 Clearly, by the lengthy record

1 that has been developed, it has garnered a lot
2 of interest. I think with it, a lot of
3 questions, and I look forward to the witnesses
4 trying to fill in some of the blanks and
5 answering questions, such as, how this would
6 really work in the "real world."

7 In the real world right now, some
8 areas in this nation are suffering from severe
9 service problems, and we have been told
10 repeatedly it's because of winter. We know
11 that the calendar says it's spring although it
12 is snowing outside and I'm sure that the rail
13 industry is working to improve the situation.
14 Patience of shippers is running low or has
15 been exhausted, and I certainly hope the
16 situation improves very soon. Thank you.

17 CHAIRMAN ELLIOTT: Thank you, Vice
18 Chairman. Our first panel today is one party,
19 the U.S. Department of Transportation. You
20 may begin.

21 MR. PERRY: Thank you. Chairman
22 Elliott and Vice Chairman Begeman, thank you

1 for the opportunity to appear here today.

2 My name is Christopher Perry and
3 I'm an attorney in the Office of the Secretary
4 of the United States Department of
5 Transportation. I'm joined today by Scott
6 Greene and Raquel Hunt, both of the Federal
7 Railroad Administration, which as the Board
8 knows, is an operating administration of DOT.

9 Scott is the Chief of the Industry
10 Economics Division of the Office of Railroad
11 Policy and Planning at FRA, and Raquel serves
12 as the Geographical Information Systems
13 Program Manager.

14 DOT appreciates the Board's
15 consideration of the import issues involved in
16 this proceeding. DOT is charged by statute
17 with promoting transportation policies and
18 programs that contribute to providing fast,
19 safe, efficient and convenient transportation
20 consistent with the public interest.

21 Thus, DOT and FRA have
22 participated in numerous proceedings before

1 the Board, involving matters of rail policy,
2 taking into account, the interest of the
3 affected railroads, shippers and other parties
4 who depend upon on the rail network.

5 DOT's role in this proceeding has
6 been a very limited one, and consequently, we
7 have asked for a very brief period of time to
8 address the Board today, primarily for the
9 purpose of summarizing the key points from the
10 Department's written submission.

11 We will then endeavor to the
12 extent possible, to answer any questions that
13 the Board may have.

14 At the outset, DOT wishes to
15 emphasize certain points about its submission
16 in this proceeding.

17 First, DOT has sought to provide
18 an objective, data-driven analysis on a very
19 limited set of issues related to the proposal
20 by the National Industrial Transportation
21 League.

22 On a variety of aspects of the

1 NITL's proposal, DOT has offered no opinion.

2 The Department has not expressed
3 views on the legal issues involved in the
4 proposal or on the wisdom of the proposal, as
5 a matter of policy.

6 Importantly, although DOT and
7 FRA's first priority is safety, we have not
8 made a comprehensive assessment at this stage
9 of any safety concerns that may arise from the
10 proposal. The DOT has also made no assessment
11 or drawn any conclusions regarding the
12 efficiencies or inefficiencies to the rail
13 network, that might result from the proposal.

14 Similarly, DOT has not initiated
15 any review or assessment regarding the
16 proposals' potential impact on the level of
17 future investment in the rail network.

18 Instead, it has been DOT's effort
19 to assist the Board in identifying the
20 origin/destination pairs that could
21 potentially take advantage of the NITL
22 proposal, as well as the rail revenues

1 reflected in those markets.

2 DOT offered this analysis in
3 response to the Board's request, expressed in
4 the order instituting this proceeding, for
5 empirical evidence on the impact of the
6 proposal on shippers in the railroad industry.

7 Second, as DOT explained in its
8 comments, the data analysis depends heavily
9 upon the assumptions that are employed. DOT
10 attempted to follow the parameters and
11 guidance provided in the Board's instituting
12 order, but we also made certain additional
13 assumptions, which are explained in more
14 detail in the written submission.

15 A variety of other assumptions may
16 be reasonably and appropriately employed here,
17 and choosing alternative assumptions may
18 result in significantly different results.

19 In deed, DOT recognizes that other
20 parties, some of whom are scheduled to present
21 testimony, have used different assumptions in
22 some instances, and DOT encourages the Board

1 to examine the proposal under those
2 alternatives, as well.

3 Under those caveats and applying
4 the assumptions set forth in the written
5 comment, DOT examined the carload waybill
6 sample, to assess the potential impact of the
7 NITL proposal.

8 In summarizing DOT's results, I
9 will refer here in certain instances, to the
10 tables provided in the Department's written
11 comment. We also have some slides, which we
12 intend to address very briefly. The Board
13 should have copies of those, and they are
14 duplicates of what was provided in the written
15 comments from DOT.

16 At the outset, the assumptions
17 that DOT applied had the effect of reducing
18 the data-set for the analysis by a substantial
19 amount, relative to the total waybill data-set
20 as a whole, as noted in Table 1 of DOT's
21 comments.

22 Among other things, DOT decided to

1 examine traffic for the four largest U.S.
2 Class I railroads, Union Pacific, BNSF, CSX
3 and Norfolk Southern, which together represent
4 over 90 percent of all Class I freight
5 revenues and carloads.

6 DOT undertook this effort, not
7 withstanding the Board's willingness to accept
8 a representative analysis, based upon the
9 traffic handled by just one of these
10 railroads.

11 In sum, as noted in Table 1, DOT
12 narrowed the data-set to 5,161 origin
13 destination pairs and 2.8 million carloads,
14 accounting for \$6.7 billion in revenues.

15 These moves were evaluated further
16 to determine whether they met the NITL 30-mile
17 test for competitive switching. These moves
18 represented 13 percent of total of freight
19 revenues and 10 percent of total carloads
20 originated, per Chart 1.

21 Next, DOT offered a more detailed
22 breakdown regarding commodities and revenues

1 for the examined traffic, and found that coal,
2 chemical or allied products and farm products
3 are the major commodity groups that could
4 potentially be affected by the NITL proposal.

5 These three commodity groups taken
6 together represented over 90 percent of the
7 revenues, in over 90 percent of the carloads
8 evaluated. This is shown in more detail in
9 Tables 2 and 3 of the Department's comments.

10 DOT consequently chose to narrow
11 its examination. Chairman, if I may have an
12 additional moment to wrap up?

13 CHAIRMAN ELLIOTT: Yes.

14 MR. PERRY: Thank you. This is
15 shown in more detail in Tables 2 and 3 of the
16 Department's comments, and DOT consequently
17 chose to narrow its examination to origin
18 destination pairs involving these three
19 commodity groups.

20 The Department then considered
21 specific origin destination pairs, to
22 determine if the shipper at issue could

1 qualify for competitive switching under the
2 NITL proposal.

3 Where the R/VC threshold of
4 greater than or equal to 240 percent was met,
5 the Department considered the shipper's
6 proximity to a Class I working interchange
7 within 30 miles, and DOT measured this
8 distance by rail route miles, as opposed to
9 linear miles.

10 After testing each of the origin
11 destination pairs for eligibility under the
12 30-mile switching proposal, DOT found the
13 roughly 360,000 carloads and \$1.1 billion in
14 rail revenues would potentially be eligible.
15 This corresponded to 1,649 origin destination
16 pairs.

17 In sum, this amounted to about 2.1
18 percent of railroad revenues and 1.3 percent
19 of carloads that would potentially be affected
20 by the NITL proposal, under the specific
21 assumptions that DOT applied.

22 Of the commodities that DOT

1 evaluated, chemicals constituted the largest
2 traffic volumes. Table 4 and Chart 2 of DOT's
3 written comment illustrate these findings.

4 Again, thank you for considering
5 DOT's submission in this proceeding and for
6 your flexibility with the timing, and we'll be
7 happy to answer any questions, to the extent
8 that we can. Thank you.

9 CHAIRMAN ELLIOTT: Thank you.
10 Vice Chairman?

11 VICE CHAIRMAN BEGEMAN: Thank you.
12 I really don't have any questions for this
13 Panel.

14 I do appreciate the effort that
15 you went to, to be responsive to the Board's
16 request for empirical data, and the way you
17 worked to try to give us something to hone in
18 on. I think it's a good kick-off to what we
19 will be hearing from other Panels, and then
20 different scenarios, but this is certainly a
21 good place to start. So, thank you.

22 MR. PERRY: Thank you, Vice

1 Chairman.

2 CHAIRMAN ELLIOTT: As well, I
3 don't have any questions, but I would like to
4 thank you.

5 Providing this type of data is
6 very important to the Board. It is nice to
7 receive data of this nature from a neutral
8 party. As a result, it makes it easier for us
9 to base our decisions on data that's not
10 provided by a party.

11 So, we greatly appreciate your
12 efforts, and I guess Mr. Greene and Ms. Hunt
13 came for no reason today, because we won't
14 give them any questions. Thank you very much.

15 MR. PERRY: Thank you, Mr.
16 Chairman.

17 CHAIRMAN ELLIOTT: Now, I'll ask
18 the next Panel to come forward, Panel II.

19 (OTR comments)

20 CHAIRMAN ELLIOTT: Feel free to
21 begin any time you're ready.

22 MR. CARLTON: Thank you, Mr.

1 Chairman. Thank you.

2 Mr. Chairman and Vice Chairman
3 Begeman, good morning. Thank you for giving
4 us this opportunity to be here this morning,
5 to testify in this proceeding. Joining me are
6 League Council Karyn Booth and Nick DiMichael
7 from the Thompson Hine Law Firm, Mr. Jay
8 Roman, President of Escalation Consultants,
9 and Walt Schuchmann, Vice President for
10 Railroad Operations Planning at the firm of
11 R.L. Banks. We're pleased to be here.

12 In July of 2011, we filed a
13 petition for rulemaking to adopt revised rules
14 for competitive switching, and bringing this
15 request to change the existing rules. Our
16 goal was to introduce a straight-forward means
17 to inject at least a measure of competition,
18 economic competition into freight rail markets
19 that are not competitive.

20 We're not asking the Board to go
21 backward. We're not asking you to re-regulate
22 the freight rail industry. We're asking you

1 to take a necessary step to promote genuine
2 rail competition.

3 Our proposal would not in any way,
4 re-establish the deep and intrusive economic
5 regulation of the past.

6 By any measure, the Staggers Act
7 has succeeded in rescuing the freight rail
8 industry, but Staggers was also supposed to
9 promote and protect the legitimate competitive
10 interests of captive shippers.

11 As you noted in your opening
12 comments, Mr. Chairman, the Staggers Act
13 specifically provided for competitive
14 switching, where practicable and in the public
15 interest, are necessary to provide competitive
16 rail service.

17 In Staggers, the Congress enacted
18 a pro-competition mandate, but since the
19 passage of Staggers, not a single shipper has
20 been able to hurdle the agency rule barriers
21 that govern competitive switching.

22 As this slides shows, since 2004,

1 rail rates have increased 2.5 times since the
2 rate of inflation and truck rates. We're not
3 asking you to open the door to -- we are
4 asking you to open the door to fair
5 competition between healthy, financially
6 strong Class I railroads for captive shippers
7 business, where that is possible.

8 To realize the promise embedded in
9 Staggers, we need a new rule to govern
10 competitive switching. You reviewed the
11 outline of our proposal. I'll do that just
12 very quickly, Mr. Chairman.

13 The shipper must show its facility
14 is served by only one Class I carrier, and
15 number two, the shipper must show that there
16 is an effective -- there is a lack of
17 effective inter and intra-modal competition
18 and number three, there is or can be a working
19 interchange within a reasonable distance of
20 the facility.

21 We've also proposed conclusive
22 presumptions to speed the process and

1 eliminate the need for costly filings and
2 litigation.

3 If the shipper can show that its
4 carrier has a 75 percent or greater market
5 share for the commodity and movement, or if
6 its R/VC ratio is greater than 240 percent,
7 then that shipper has conclusively
8 demonstrated a lack of competition.

9 Likewise, if the shipper's
10 facility is located in a switching terminal or
11 within 30 miles of an interchange, then that
12 shipper has conclusively met the reasonable
13 distance criterion, and while these conclusive
14 presumptions are designed to simplify the
15 process, they in no way, limit a captive
16 shippers access to competition.

17 Importantly and often overlooked,
18 we have also proposed that the incumbent
19 railroad may block the shipper's request by
20 demonstrating that the requested switch is
21 unsafe, infeasible or harmful.

22 Our proposal is modest. It's fair

1 to both carriers and shippers, and we don't
2 believe it's harmful to either.

3 The League has provided
4 analytically sound answers to the questions
5 posed by the Board on the economic impact of
6 the proposal and this morning, we're going to
7 dive deeply into those analyses.

8 In the United States, competition
9 is our default economic model for one simple
10 reason, it works.

11 Competition makes every business
12 better. Competition grows the economy. It
13 maximizes efficiency and productivity. There
14 are practical limits on pure competition in
15 the freight rail industry, and no one is
16 suggesting that we build one or 10 or hundreds
17 of railroads to compete for a shipper's
18 business.

19 We're asking the Board to promote
20 competition, by publishing our proposed rule
21 as a notice of proposed rulemaking.

22 Head-to-head competition for a

1 captive rail shipper's business, where
2 physically possible, should not be feared or
3 resisted. Competition was envisioned in
4 Staggers and should be a positive policy goal
5 for the Board, and now, I'll turn this over to
6 Karyn Booth, our Lead Counsel, who will begin
7 our deeper dive into the proposal.

8 MS. BOOTH: Thank you, Bruce.
9 Let's see, is this on? Good morning. Here we
10 go.

11 Good morning, Mr. Chairman. Good
12 morning, Commissioner Begeman. It's a
13 pleasure to be with you this morning, on this
14 very important topic. Can we just flip this
15 over?

16 As you mentioned, this proceeding
17 was started so that the Board could get a much
18 closer look and a better understanding of the
19 impacts of the Leagues' competitive switching
20 proposal on shippers who qualify under the
21 proposal, on those who don't qualify, and on
22 the railroad industry and their networks and

1 their revenue.

2 As Mr. Carlton indicated, the
3 League has fully responded to your questions,
4 and have provided you with very detailed
5 analyses in our submissions, and we're pleased
6 to be here to share with you, those results.

7 Now, before we get really deep
8 into some of the details here, I did want to
9 start with just a broad overview and a
10 framework of the findings that NITL has
11 presented to you.

12 First, the CSP is consistent with
13 the Staggers Act. Mr. Chairman, you outlined
14 the statutory provision and there are
15 alternative standards that can be met under
16 the statute. The CSP meets both of those.
17 It's in the public interest and it will
18 facilitate rail competition.

19 Second, the CSP, its impacts on
20 both shippers and railroads are balanced.
21 This proposal was balanced right from the
22 start. It was designed to require certain

1 conditions to be met. It is not open access
2 by any stretch.

3 It includes fair indicators of
4 market power that has to be shown by the
5 shipper, before it can obtain relief, and it
6 also specifically addresses concerns that
7 might exist with safety or service or rail
8 operations.

9 What we have shown is that the CSP
10 will inject a reasonable amount of rail
11 competition into the market place, and again,
12 it is not open access or it doesn't provide
13 automatic rights to every captive shipper,
14 despite the fact that there are many shippers
15 who would prefer such a system.

16 We have shown that the CSP will
17 not harm the railroads economically or
18 operationally. This is because the CSP will
19 inject competition that will provide important
20 benefits to shippers, including cost savings,
21 but these cost savings are reasonable and they
22 are a small fraction of the railroad gross

1 revenue and net revenue, which appears in the
2 reporting.

3 It also would result in a very
4 small fraction of traffic that would actually
5 change hands, and this amount of traffic can
6 be easily absorbed by the very flexible rail
7 networks, which is the most modern and one of
8 the best systems in the world.

9 Now, when you look at the studies
10 that have been presented, you do need to make
11 some comparisons, and we would note that the
12 NITL analysis is far more consistent with the
13 other studies that have been shown, including
14 that of the Department of Transportation.
15 Some of their findings are more similar to
16 our's, and the approach that they've taken,
17 along with USDA and National Grain and Feed.
18 We've all taken similar approaches.

19 Okay, in contrast, the AAR
20 (American Association of Railroads) analysis
21 is incomplete, and it's also misleading. They
22 have ignored key questions that you presented

1 in your notice and they've ignored key aspects
2 of the CSP proposal itself.

3 They have included assumptions
4 that make no sense. They are divorced from
5 reality and they lack credibility.

6 Competitive switching will benefit
7 the public interest. We have shown that to be
8 so, and you too, will reach that conclusion
9 when you look at the serious studies that have
10 been provided to you.

11 This proposal supports change that
12 is consistent with Staggers. The data is
13 clear, it will facilitate competition and
14 choice and innovation for captive shippers.

15 It will allow the market to set
16 prices by giving a shipper who is captive, the
17 opportunity to go to a second carrier and get
18 a bid.

19 It will reduce the need for
20 regulation, by giving shippers that
21 opportunity.

22 We strongly urge you, based on the

1 record in this proceeding, which is now,
2 mountains high, if you combine ex parte 705
3 and ex parte 711. We urge you to open a
4 rulemaking and allow for additional comment on
5 this proposal.

6 Now, with that, I'd like to begin
7 following that just general overview of our
8 findings, with a quick summary of your
9 authority to make the changes that are needed,
10 to bring the benefits of competition to
11 qualifying shippers, and then we will get into
12 the specific evidence submitted by NITL and
13 other parties.

14 So, with respect to the Boards'
15 authority, again, the statute is clear. It is
16 broad. It is permissive. You can grant
17 switching, as long as it's practicable and in
18 the public interest or necessary to provide
19 competitive rail service.

20 There are no conditions here.
21 There are not restrictions or limitations that
22 require competitive abuse, monopolization,

1 service problems, despite the fact that you're
2 going to hear that. That is not what Congress
3 said needs to be shown.

4 The legislative history on this
5 provision has been set forth in our filings,
6 and your role is to encourage competition to
7 address problems where they exist.

8 The existing rules are entirely
9 unworkable. The evidentiary burdens that must
10 be shown by shippers, the complexity of those
11 proceedings, the costs make the current rules
12 insurmountable. No shipper has ever been able
13 to meet those standards. It just doesn't make
14 sense.

15 It can't be that Congress intended
16 to provide competitive relief, but nobody can
17 access it.

18 You have the discretion to make
19 change. The statute gives you that discretion
20 and it's ludicrous to hear that the current
21 rules are etched in stone and can never be
22 changed.

1 The statute is clear. We've given
2 you cases in our filings, which show, as long
3 as there is a need for change, there is a
4 reason for change, you can make that change
5 and you should do that here.

6 The current rules are just one
7 interpretation. It's been found to be
8 reasonable, many, many years ago. It doesn't
9 mean that it's the only interpretation of
10 Congress' intent.

11 Now, there is no doubt that we
12 have a very different rail industry today.
13 We're not going to go into all of that.
14 You've got that in the record, but not only
15 should you make change, but you need to make
16 change.

17 I will now turn to the specific
18 questions posed by the Board, and we'll start
19 with Question Number 1, which you asked for
20 information on existing terminals and
21 shippers.

22 Now, with respect to this

1 question, we couldn't get data on this issue
2 from the waybill itself, and so, what NITL did
3 is, it turned to the railroads public tariffs,
4 to see what we could glean in their switching
5 arrangements, and we were able to find some
6 information for you.

7 Those tariffs show terminals that
8 are currently open to switching. They
9 identified the shippers who will have access
10 to switching. It shows the commodities that
11 can have access to switching, as well as
12 switching rates, and essentially what those
13 show is that all the major railroads engage in
14 this practice, and there are obviously, a
15 number of shippers who can benefit from it.

16 But it's also very clear that
17 there are shippers at terminals with
18 competition where switching takes place, who
19 can't access it.

20 So, really today, switching is a
21 one-way street. It's done between railroads
22 by agreement, when it's primarily to their

1 benefit, but that's not what Congress said.

2 That's not the public interest standard.

3 We also were able to get a view of
4 the switching fees that the railroads have in
5 place, and what we were able to learn is that
6 they're generally consistent.

7 In the West, we see that on
8 average, \$200 to \$300 per car and on the East,
9 it's generally about \$400 to \$500 per car, and
10 we're going to be getting into the assumed
11 methodology that NITL used in this proceeding,
12 which also is very consistent with those
13 current switching arrangements.

14 I'd like to leave you on this
15 point, to say that what we're trying to do
16 here in this proceeding is simply to expand on
17 an existing practice, on something that's
18 taken place in this country for many years.

19 The railroads switch every day,
20 and we believe that expanding those switching
21 opportunities to bring competition to those
22 captive shippers is a reasonable approach.

1 With that, I'd like to turn this
2 over to Nick DiMichael and Jay Roman, to
3 address the next question.

4 MR. DiMICHAEL: Thank you, Karyn.
5 I would like to focus for a while, Jay and I
6 would like to focus for a while on Question
7 Number 2, that the STB asked, the issues about
8 carloads and revenue that would be subject to
9 switching under the CSP, and just to give kind
10 of a general approach first.

11 Mr. Chairman, you noted that the
12 NITL proposal dealt with certain shippers that
13 "lack competitive alternatives" and under our
14 proposal, there were two primary presumptions,
15 the 75 percent presumption, where shippers
16 that would be tied to railroads for at least
17 75 percent of their moves would be presumed to
18 be within that group, as well as shippers who
19 have had an R/VC for their movements of over
20 240 percent.

21 Our study looked at both of those
22 presumptions and the effect of both of those.

1 We were the only ones who really did that.

2 The AAR looked solely at the 75 percent.

3 Like DOT however, we focused on
4 the 240 percent presumption because that had
5 the key data in the waybill and we've taken a
6 lot of the deep dive into that.

7 We looked at assumed pricing
8 methodology, and the Board asked us
9 specifically to do that, and we did, and I'll
10 talk about that in just one minute.

11 We also took into account a whole
12 variety of factors necessary to get to the
13 carloads and dollars, and Mr. Roman will be
14 focusing on those, and we calculated answers
15 to all of the questions asked by the Board,
16 because the Board asked not only to take a
17 look at what the effect was under the NITL
18 proposal, but also to vary it by using, for
19 example, the RSAM instead of the 240, and
20 also, varying the 30 miles and we took at look
21 at that.

22 In all of this, the idea was to

1 get how many -- get the answer to the
2 question, how many carloads are actually
3 affected by the NITL proposal?

4 The first key aspect to that was
5 to get to an assumed access pricing
6 methodology, and the Board in its decision,
7 said that an access price would be a
8 "significant factor in determining the extent
9 to which a broad competitive switching
10 requirement could affect qualifying shippers".

11 We looked at that, and I will tell
12 you the AAR did not. Our assumed access fee
13 was based on the Canadian switching model, the
14 inter-switching fee that is set by the
15 Canadian Transportation Agency.

16 We looked at that fee because for
17 a whole variety of reasons. It is cost based.
18 It is reviewed in detail by the regulatory
19 agency. It is based on an analysis of actual
20 operations up in Canada, the number of
21 switches, etcetera, and it's intended to cover
22 the total cost of the switching.

1 The access fee that we came up
2 with, as you'll see on the screen, is a \$300
3 switch fee for single cars and an \$89 switch
4 fee for switches of 60 cars or more.

5 What is also significant about
6 that switch fee however, is that that \$300 is
7 quite consistent with the UP and BNSF average
8 switch fee in the West of about \$250 a car,
9 and the NS and CSX average switch fee in the
10 East of about \$400 a car.

11 As Ms. Booth suggested, we took a
12 look at the railroad published tariffs,
13 because the rail -- each railroad publishes
14 tariff which sets forth its switch fee for the
15 various industries that it serves, and we were
16 pleased to see that the switch that we had --
17 that we had developed, the \$300 switch fee,
18 was certainly in the ballpark of existing
19 privately negotiated switch fees that the
20 railroads themselves have developed.

21 It is important that the switch
22 was done, because on the basis of that switch

1 fee, we were able to calculate then, the
2 number of cars that would fit under the NITL
3 proposal, and Jay, let me turn this over to
4 you and go into the deeper dive.

5 MR. ROMAN: Okay, thanks, Nick.

6 Let's see, I'm on here.

7 Let's see, I'm going to go through
8 the methodology we used to determine impacted
9 carloads and impacted revenue under NITL's
10 analysis, and I would say in order to
11 determine the economic impact of the CSP on
12 both the shippers and the railroads, we needed
13 to take a look at both non-revenue factors, as
14 well as revenue factors.

15 Both these type of factors
16 essentially form sieves or filters that a
17 movement needed to get through, in order to
18 qualify for competitive switching under the
19 CSP.

20 The first type of factors we
21 looked at were non-revenue factors, and these
22 are important because they essentially

1 represent the conditions of the CSP that a
2 movement must satisfy, in order to even be
3 preliminarily considered under the CSP.

4 If I could go to the next
5 illustration. Here is an illustration showing
6 our non-revenue factor sieve and the little
7 balls at the top of the sieve all represent
8 different things we needed to look at, to see
9 if a movement will qualify getting through our
10 non-revenue sieve, and I'm not going to touch
11 on all of these, because they're detailed in
12 the testimony, but I do want to reference a
13 few of them.

14 Number one is the origin of
15 station captive or competitive?

16 Well, if the answer is, it's
17 competitive, at the origin and destination,
18 it's thrown out because the CSP wouldn't be
19 applicable. It's already competitive.

20 The next one is a really important
21 factor. If station is competitive, is the
22 industry captive?

1 There is a very large number of
2 stations where the industry is served by only
3 one railroad, but it is the -- the industry is
4 served out of a station which has competition
5 with more than one railroad.

6 So, the station has competition,
7 but the industry is captive, and we called
8 these captive industry movements, and we had
9 to develop protocols using the waybill to
10 determine captive at industry movements, and
11 it was an important determination because
12 there is a lot of movements in our analysis
13 that were impacted because they were captive
14 at industry, and it really increased the
15 results.

16 The next one, is the station
17 within 30 miles of a working interchange, and
18 for this, we looked at 30 rail models, because
19 those were the miles that the railroad had to
20 move from a captive station to a working
21 interchange.

22 There is a number of other things

1 that needed to get through our non-revenue
2 factor sieve, but essentially bottom line, in
3 order to get through this sieve, a movement
4 had to currently be captive and as a result of
5 the conditions of the CSP, it had to change to
6 be competitive.

7 If that change actually occurred,
8 it qualified under our non-revenue factors.
9 It qualified under the conditions of the CSP.

10 But that data that came through
11 the non-revenue sieve then needed to be summed
12 up, and we -- to sum this data up, we needed
13 to put it through a revenue sieve, and the
14 revenue sieve is really, in its macro-sense,
15 pretty basic.

16 We had to determine whether on
17 movements that were impacted by the CSP,
18 whether the new rate, including the rate that
19 was provided by the railroad for the movement
20 that was impacted, as well as the access fee,
21 whether that new cost of the movement was
22 greater or less than the existing rate for the

1 movement.

2 What I've put up on the screen is
3 really what our revenue sieve is, and I'll
4 just go through the numbers here, to show you
5 how this works.

6 For an impacted move, let's say we
7 have an existing rate of \$4,000. Our rate
8 after the competitive switching proposal, the
9 rate that the railroad would provide for
10 movements impacted by the CSP, we're saying
11 the rate is \$3,100, the access fee is \$300.
12 So, our total cost after the CSP is \$3,400.

13 Well, the existing rate is \$4,000.
14 So, the CSP would reduce this movement by
15 \$600. So, we would say, this made it through
16 the revenue sieve. It's an impacted movement.

17 In the next column to the right,
18 we have the calculation for movements that did
19 not make it through this sieve.

20 Here, we're saying the existing
21 rate is \$3,000. Our total cost after the CSP
22 is still assumed to be \$3,400. Well, \$3,400

1 is greater than the existing rate of \$3,000.

2 So, this movement did not qualify.

3 So, we needed to put movements
4 through a revenue sieve because shippers are
5 not going to be using the CSP if the rate that
6 would result from this is greater than what
7 their existing rate was.

8 A lot of movements do not qualify
9 when you put them through the revenue sieve.
10 So, we found it a very important part of our
11 analysis, or to put this another way, if you
12 did not consider the revenue sieve, your
13 impacted carloads and your impacted revenue
14 are just going to be substantially over-
15 stated.

16 Now, in any economic analysis,
17 we're looking at something general here, but
18 in any economic analysis, the devil is in the
19 details, and our little devilish details up
20 here are in the rate after the competitor
21 switching proposal, because that rate that we
22 assumed the railroads will provide, if it's a

1 very low rate, a lot of movements will make it
2 through the revenue sieve. If it's a high
3 rate, very few movements are going to make it
4 through the revenue sieve.

5 So, we calculated the rate after
6 the competitive switching proposal, the rate
7 the railroads would provide, two different
8 ways.

9 First, we assume full competition,
10 and under full competition, we assumed that
11 the railroads would provide the average
12 current competitive rate for this moment that
13 they currently get for competitive traffic.

14 To do this, we looked at the
15 carload waybill statistics, and we broke the
16 waybill up for all single-line haul movements
17 on each railroad that had less than 180
18 percent revenue to variable cost ratio. Then
19 we broke that data down and we did it by
20 commodity code.

21 So, we looked at all the
22 competitive rates that we're assuming under

1 180 as competitive, all the competitive rates
2 for each commodity code, and we broke down by
3 five -- to the five-digit commodity code and
4 then we broke it down by mileage range.

5 So, in looking at this, we have
6 developed a database, which shows the average
7 current competitive rate the railroads are
8 providing for each commodity code, and if I
9 could go back to the previous illustration
10 there.

11 So, in our rate after the CSP,
12 under full competition we have assumed that
13 the railroad would provide the average current
14 competitive rate it currently gets for
15 traffic.

16 But we also look at this and say,
17 it is really probably not likely that the
18 majority of the rates the railroads provide
19 will be equal to its average competitive
20 rates, because when we look at movements that
21 are impacted by the CSP, the best you're going
22 to get is duopoly competition, only

1 competition between two railroads, and one of
2 those railroads is current access fee. So,
3 they can't compete as vigorously for the
4 traffic.

5 Here, we're only looking at intra-
6 modal competition, which means competition
7 from other modes is not going to be here.

8 So, we think it's likely that the
9 railroads would be providing a rate higher
10 than what their average competitive rate is
11 they're currently providing.

12 So, in order to develop a scenario
13 which was less than full competition, what we
14 looked at was the Lerner Index, and the Lerner
15 Index is an index that is widely known. It
16 represents an economic theory which attempts
17 to qualify the effect of the degree of market
18 power an individual company has, and when we
19 used the Lerner Index, it increased the rate
20 up for our -- for the rate that the railroads
21 would provide after the CSP was applied.

22 When we raise up the rate for a

1 rate that isn't totally competitive, all of
2 the sudden, the number of movements that make
3 it through our revenue sieve reduce, and
4 you're going to see that in the results that
5 we'll show now.

6 In looking at full competition,
7 where the rate is based on the average current
8 competitive rate for a movement, we have
9 1,240,000 carloads impacted under the 240
10 percent revenue condition, and this is based
11 on the four railroads, BN, CSX, UP and Norfolk
12 Southern, and it's also based on the 30 rail-
13 mile consideration.

14 Now, in addition, the CSP
15 references the 75 percent of traffic
16 condition. To determine the movements that
17 would be impacted under the 75 percent
18 condition, we went to a different source. We
19 went to the Department of Commerce.

20 The Department of Commerce has a
21 commodity flow report, which shows that there
22 are only four commodities which have more than

1 25 percent of their tons shipped by rail, and
2 then we looked at these as the commodities
3 that would most likely qualify under the 75
4 percent condition.

5 So, when we put these movements
6 for these four commodities through our sieves,
7 we come up with 200,000 carloads impacted, and
8 one of the reasons the 200,000 carloads under
9 this condition is so much less than the 240
10 percent R/VC condition is because any of these
11 movements under the 75 percent condition, if
12 they have a 240 percent R/VC, they're already
13 considered under the 240 percent R/VC
14 condition.

15 So, we come out with 1.44 million
16 carloads being impacted, and that represents
17 4.6 percent of all rail carloads. There were
18 33 million carloads in 2010, the year from the
19 analysis. So, it's 4.6 percent.

20 When we look at this at less than
21 full competition, all of the sudden, the
22 number of movements reduces because not as

1 many movements make it through the revenue
2 sieve.

3 So, we have a total carload of
4 1,200,000, which represent 3.9 percent of the
5 total carloads of the four major railroads.

6 Now, this is our carload
7 comparison, and we look at these results and
8 we spent a lot of time and a lot of midnight
9 hours, trying to develop a model that could
10 consider all of the conditions of the CSP, but
11 if we could go to the next illustration.

12 We also find the results that
13 we're providing are over-stated, and they've
14 over-stated for some basic reasons.

15 Number one, we included all exempt
16 traffic. The only thing we excluded in our
17 numbers was inter-modal movements. So,
18 traffic that is exempt is included in our
19 data.

20 In addition, we included all
21 contract traffic, and movements wouldn't be
22 applicable until after their contracts

1 applied, but we said they all apply at once.
2 They would actually come in gradually, and we
3 ignored many paper barriers, simply because we
4 don't know where they are.

5 To the extent that the CSP does
6 not supercede the paper barrier, our numbers
7 are going to be over-stated as -- because the
8 -- where the paper barriers are, would very
9 likely not apply.

10 So, we've looked at a lot of
11 different scenarios and I guess what we would
12 say, we think that our results probably
13 represent the upper bounds for what would be
14 impacted under the CSP, and with that, I'll
15 turn it back over.

16 MR. DiMICHAEL: Mr. Chairman, I
17 would note a couple things.

18 It was very good that DOT was up
19 here first, and we kind of see that our
20 analysis is generally consistent with DOT's.

21 DOT indicated that about 360,000
22 carloads would be impacted, focusing on three

1 major commodity groups. We looked at all of
2 the commodity groups, rather than just the
3 three.

4 DOT excluded exempt commodities.
5 As Mr. Roman just said, we included those, to
6 be sure we covered everything, and DOT looked
7 at single-line movements only. We looked at
8 both single-line and joint-line movements, but
9 our numbers were 1.44 million. It is at least
10 in the same ballpark, we think, as far as DOT
11 is concerned.

12 Contrast that however, with the
13 results of the AAR's study.

14 DOT indicates that 360,000
15 carloads would be impacted. We indicate that
16 1.44 million carloads would be impacted. The
17 AAR believes that 7.5 million carloads would
18 be impacted, 20 times DOT's figure.

19 Why is the AAR's figure so high?
20 Well, there is really two reasons for that.

21 Number one, the AAR addressed only
22 the 75 percent market share under what they

1 called a default assumption. Basically, their
2 default assumption said that we are going to
3 assume that a shipper at a single-serve rail
4 station, all of his traffic, his traffic, his
5 rail traffic automatically meets the 75
6 percent presumption. Let's just think about
7 that for a minute.

8 You have a point at which a
9 shipper ships 100 carloads by rail, and ships
10 1,000 carloads by truck. That doesn't look
11 like a captive situation.

12 But what the AAR would do is to
13 say those 100 carloads, because they're served
14 at a single-serve rail station, those are
15 potentially, you know, eligible for the CSP.

16 So, it was a -- this huge
17 expansion in the potential number, and the AAR
18 didn't stop with the problem there. They also
19 went to a second problem. They did not do all
20 of the things that Mr. Roman noted needed to
21 be done in order to actually qualify moves.

22 So, for example, taking a look at

1 -- take a look at that 100 carloads again.
2 The AAR never looked at what rate those cars
3 were actually paying.

4 Was it going to be better or worse
5 than the rate that they could get out of the
6 CSP?

7 So, the AAR had this huge
8 expansion and then refused to take a look at
9 any factor that would reduce that over-stated
10 number.

11 With that, Jay, why don't you talk
12 quickly then, about the rates and the revenue
13 that would come out?

14 MR. ROMAN: Right, as a
15 continuation of the impacted carloads, I'll
16 talk about the impacted revenue. If we could
17 go to the next illustration.

18 Under full competition, the
19 impacted revenue, for 240 percent R/VC
20 condition, we're dealing with billions of
21 dollars here, \$1,294,000,000 would be impacted
22 under the 240 percent R/VC condition on the

1 four railroads with 30 miles to an
2 interchange.

3 Under the 75 percent of traffic
4 condition, we have 115 million, and once
5 again, the reason this amount is so much
6 smaller than the -- under the 240 percent
7 condition is because it's -- anything with 240
8 percent is already considered in the first
9 row.

10 So, our total shipper savings are
11 \$1,408,000,000. This represents 2.6 percent
12 of the total revenue for the four railroads,
13 which was \$52.9 billion in 2010.

14 As a percent of net revenue, it
15 represents 9.8 percent of the \$14.3 billion in
16 net revenue for the revenue, and that's the
17 condition under full competition.

18 In the next illustration, we show
19 what the results are in less than full
20 competition. Here, we're looking at total
21 shipper savings of under \$1 billion, \$946
22 million. It represents 1.8 percent of the

1 total revenue and it represents 6.6 percent of
2 the net revenue for railroads.

3 So, when you're looking at both of
4 these scenarios, you're dealing with somewhere
5 around \$1 billion in revenue that would be
6 impacted, and \$1 billion is a lot of money,
7 but when you take a look at it, how it's
8 broken down, it gives you a different picture.
9 If we could go to the next illustration.

10 Here is a map of the United
11 States, which shows in the blue pies, the size
12 of the pie represents the total rail revenue
13 of the four major railroads in each state.

14 The size of the pie is determined
15 by the amount of revenue in each one of the
16 states. The little red slice we have in each
17 one of the pies in the states, that represents
18 the reduced revenue that would result under
19 the CSP under full competition.

20 Due to the size of the pies in
21 many of these states, you can't even see what
22 the reduction is within those states. So, and

1 this is under full competition.

2 If we are dealing with reduced
3 competition, these slices of the pie get even
4 smaller, and if you consider the things we
5 were talking about earlier, that we believe
6 that our analysis is the outer range for what
7 would be impacted, this is really
8 demonstrating that there is not a huge impact
9 from a geographic area, when you're looking at
10 these states, and when you consider that this
11 is just static reductions with the railroads,
12 economics is going to dictate if the railroads
13 provide lower rates, they're going to get
14 increased revenue.

15 This is really demonstrating
16 rather minimal impact on the railroads from
17 the competitive switching proposal, and with
18 that, I'll turn it back over to Karyn.

19 MS. BOOTH: Jay, thank you very
20 much. The next question would be Question
21 Number 4, what's the impact on existing
22 captive shippers, but in the interest of time,

1 we'd like to move to Question 5.

2 We have submitted substantial
3 evidence on Question 4 in our filings, and
4 certainly, we'll be happy to answer any
5 questions, and so, with that, I'd like to turn
6 to Question Number 5, which was the impact of
7 the CSP on rail network efficiency, and this
8 is an issue in which NITL and AAR again, have
9 very different perspectives.

10 You're going to hear in just a
11 very short time, that the CSP is going to be,
12 you know, devastating to the rail industry and
13 that it will harm not only their operations,
14 but service to shippers, but these claims are
15 very much without any merit, and that is
16 because their position is, you know, number
17 one, contradicted by the data in the record,
18 and from what you just heard, which is that
19 there is a very modest number of impacted
20 carloads and additionally, as we're going to
21 talk about in a minute, there is a even a
22 smaller number of cars that would actually be

1 switched.

2 Their position is also
3 contradicted by the fact that they have a very
4 flexible rail network, and they have shown
5 themselves to be very capable to handle normal
6 traffic swings, which are much greater than
7 the number of switches that would occur under
8 the CSP, and additionally, their position is
9 contradicted by actual experience of an
10 existing switching regime in Canada, which
11 shows that there are -- which is far broader
12 than the CSP and shows that the Canadian
13 railroads have had no difficulty in with their
14 operations and service to other shippers.

15 So, with that, the AAR is going to
16 try to make this a very complicated issue, but
17 in fact, we submit to you it's not, and that
18 there are really three key issues that you
19 need to look at, when you evaluate the impact
20 on network efficiencies.

21 Number one, what is the number of
22 carloads potentially eligible to be switched,

1 and we just talked about that.

2 Number two, within that universe
3 of carloads, what is the percent of that
4 carloads that would actually engage in
5 switching and change carriers, and number
6 three, once you have that figure, what is the
7 ability of the existing railroads and their
8 networks to handle that traffic, and I'd now
9 like to address each of those issues in turn.

10 I'm not going to spend a lot of
11 time on the first factor. You just heard how
12 NITL, in a very detailed way, developed its
13 carload estimate. So, that is factor number
14 one, the fact that 1.44 million carloads would
15 be eligible, potentially eligible for
16 switching, which is very different from the
17 7.5 million carloads estimated by the AAR, and
18 our estimate is a very small fraction of the
19 railroads total traffic. That's the big four
20 railroads of 31 million cars.

21 The second factor is really the
22 important one here, as well, and that is of

1 the universe of those eligible carloads, what
2 is the percentage of cars that would actually
3 change carriers, and what NITL did to try to
4 develop that figure was we looked again, to
5 Canada, an existing switching regime. It's
6 been around for over 100 years. It's gone
7 through extensive reviews, periodically.

8 We were able to look at the data
9 in Canada, and discern of all of the traffic
10 eligible in Canada for switching, how much of
11 that traffic actually switches, and it's a
12 very small percentage.

13 Approximately 40 percent of all
14 rail traffic in Canada is eligible for
15 switching, which makes sense under that
16 regime, since that's an automatic right to
17 switching. It's a much broader proposal than
18 what we have here.

19 What we learned from that data was
20 that only 10 to 17 percent of all that traffic
21 eligible in Canada actually switches to a
22 second carrier, and why is that?

1 Well, that's because there are
2 strong incentives for the incumbent carrier to
3 actually keep its business.

4 When you engage in switching, it
5 obviously is going to involve some additional
6 handling. It could increase traffic time.
7 You have to add the switch fee that we already
8 discussed. So, there are service
9 considerations. There are cost considerations
10 that come into play what -- to determine
11 whether or not a car will actually be switched
12 or not, and that incumbent carrier often is in
13 a superior position to perhaps, lower its rate
14 modestly, to keep the business.

15 So, looking at what we learned
16 from the Canadian system, we applied that 10
17 to 17 percent, what we're calling diversion
18 percentage, to the NITL carloads, that
19 potentially qualified, and what that yields is
20 that the estimated number of carloads that
21 would actually switch to a second carrier is
22 less than 250,000 cars.

1 Okay, that is an extremely small
2 percentage of traffic, when you look at the
3 fact that in 2010 alone, 5.4 million cars were
4 interchanged on this rail network.

5 This is a much smaller percentage
6 than the actual traffic swings these railroads
7 deal with every year, and what I'd like to do
8 is turn now to Mr. Schuchmann, who is going to
9 address in more detail, the ability of the
10 rail industry to handle the number of cars
11 that would actually switch, and to also
12 address some of the other operational
13 considerations.

14 MR. SCHUCHMANN: Good morning. We
15 are confident that the railroads can handle
16 the traffic swings expected under CSP.

17 Traffic patterns are constantly
18 changing on the railroads. Not only do total
19 volumes grow and diminish, but lines of
20 business shift and increase and plummet.
21 Traffic changes between carriers. Traffic
22 changes in routing.

1 So, while it's easy to look at a
2 gross number, underneath that number, rail
3 traffic is constantly changing.

4 The 250,000 carloads that might
5 change are much less than some of these swings
6 within lines of business and within to total,
7 and as we will see on the following slide, the
8 250,000 carloads is dwarfed by some of the
9 year-to-year traffic changes.

10 Look please, at 2007, where we see
11 the smallest change in volume. That was
12 655,000 cars in a year-to-year change in that
13 year. The mid-point of this slide is seen in
14 2006, at 972,000 cars. Again, a year-to-year
15 change, and the highest swing was 2009, a
16 decline of 4.5 million cars followed the next
17 year by a rebound of 3 million cars.

18 Now, no one suggested 2009 was a
19 normal year, nor that it was easy for the
20 railroads to handle these challenges, but the
21 point is, as our railroad system did overcome
22 these challenges, kept operating and certainly

1 can handle the gradual re-routing of only
2 250,000 cars, if the impacts are in deed, that
3 high.

4 We submit that the impacts of CSP
5 will be muted, that they will take place
6 gradually, partly because one-third of rail
7 traffic is under contract, and won't be
8 eligible for diversion until those contracts
9 terminate.

10 Also, logistics managers will be
11 cautious in taking advantage of CSP, and will
12 test routes and they will not rush to throw
13 all their traffic into unproven and unknown
14 routes.

15 Even if the traffic is the full
16 250,000 carloads though, the number of
17 interchange activities will be much smaller
18 because many cars travel in blocks, and in
19 fact, many of these activities will just be
20 the addition of a few cars to an existing
21 interchange activity that takes place anyway.

22 Railroads have been interchanging

1 cars for nearly two centuries. In a modern
2 era, there's been plenty of time since the
3 Staggers Act and the creation of the mega-
4 system today, to select interchange locations
5 and procedures.

6 The focus of CSP is on working
7 interchanges, where railroads already have
8 personnel, equipment and procedures in place.
9 Could you go back, please?

10 Railroads have terrific modern
11 computerized tools to develop their operating
12 plans and to adjust them. Mr. Rennicke's firm
13 of Oliver Wyman produces the widely used
14 software package that is used to develop these
15 plans, and they are capable of change, even on
16 a daily basis, as needed.

17 Finally, it speaks for itself,
18 that competition will encourage both
19 incumbents and CSP railroads to develop new
20 efficiencies as it occurs in lanes where there
21 currently is no competition.

22 We can look north of the border

1 for some indications of what will actually
2 happen, and we've talked about that.

3 Regulated switching has been in place and
4 studied. The diversion percentage is
5 relatively slow, around 10 to 17 percent.

6 The regulatory proceedings have
7 found that there have been no material impacts
8 on service and operations, and Canadian
9 national and Canadian Pacific have taken place
10 in those proceeding.

11 Railroads in Canada have never
12 performed better, whether because of or
13 despite inter-switching. Canadian Pacific's
14 operating ratio last year was an all-time
15 record of just under 70 percent, and Canadian
16 National was even better, at approximately 63
17 percent.

18 AAR is wrong about the impacts of
19 CSP on our rail network, because they over-
20 state carloads.

21 We've talked about that. Their
22 gross number that could be eligible is too

1 high because they didn't filter it properly.
2 They use a high and unsubstantiated estimate
3 of 25 percent that will be diverted. The 25
4 percent is strictly a made-up number.

5 The Canadian experience is much
6 less, but even if you apply their 25 percent
7 to our base of 1.4 million impacted cars,
8 results in diversion are less than 400,000
9 cars a year, and that number is much smaller
10 than some of the changes that we've seen in
11 earlier slides, and it's a fraction of the
12 total annual volume of 30 million carloads.

13 AAR is also wrong about the impact
14 to the rail network, because it under-states
15 the capabilities and over-states the fragility
16 of the U.S. rail network. Now, that, seems to
17 me, an odd position for the AAR to take.

18 AAR goes into a lot of detail
19 regarding some interchange examples that are
20 speculative and may not even occur. They're
21 really just crying wolf.

22 They imply that the interchange is

1 so difficult that the system will be
2 overwhelmed, but I don't think that there is
3 any reason to believe that our system is fine-
4 tuned to the point of collapse.

5 Look at the ability that has been
6 documented to handle traffic growth and
7 swings, and I can say from personal
8 experience, in supervising interchange
9 activities in Chicago and other places, that
10 whatever the configuration of the traffic,
11 whatever the volume of the cars or the ebb and
12 the flow, whatever the weather and conditions,
13 railroaders just get out and get it done.
14 Interchange is part of railroading and part of
15 a day's work.

16 AAR is high in the number of
17 interchanges per carload. We submit that it
18 could be much less, as low as perhaps one
19 percent change in the number of interchanges
20 per carload.

21 AAR implies strongly that the
22 railroad productivity gains are solely a

1 result of the increase in interchanges -- a
2 decrease in interchanges that has occurred,
3 but that is not correct.

4 All in this room, there are
5 mergers, improved locomotives, concentrations
6 in traffic, higher capacity trains and many
7 other things that have boosted rail
8 productivity.

9 Railroads have proven that they
10 can and will handle interchanges and increased
11 interchanges, when they want to. Witness the
12 formation of Conrail, which interchanges cars
13 with its parents. Witness the tripling of
14 short-lines since Staggers, and remember that
15 ever car interchange between a Class I and a
16 short-line is a new interchange activity.

17 Finally, the AAR says in its
18 printed materials, and Mr. Rennicke has said
19 that America has the best freight railroad
20 system in the world, and I fully agree with
21 that.

22 I think that our rail system will

1 take the modest over-time manageable impacts
2 of CSP in stride and never look back.

3 MS. BOOTH: Mr. Chairman.

4 CHAIRMAN ELLIOTT: Please take
5 your time.

6 MS. BOOTH: It is -- yes, we'll
7 wrap this up quickly for you. I think we're
8 going to skip a couple slides and if I could,
9 I'd like to make just one more substantive
10 point, and then we'll go ahead and get to our
11 conclusions.

12 Yes, we're on the correct slide
13 here.

14 So, despite, you know, our showing
15 and our explanation here that the CSP does not
16 harm railroad networks, we do want to
17 emphasize that the CSP itself is designed to
18 allow for this Board to engage in an
19 evaluation of any safety issues, operational
20 concerns, etcetera, that might exist in the
21 context of a specific location in the country,
22 in the context of a specific switching

1 petition that might be brought.

2 So, that's because under the CSP,
3 while the shipper has certain conditions it
4 would have to meet, the railroads then would
5 also be able to raise, under the design of the
6 proposal, any concerns that they specifically
7 would have, as mentioned, with service or
8 operations, etcetera, and they would do that
9 by making a showing that the switching may not
10 be feasible operationally, that it might be
11 unsafe for whatever reason, or that it could
12 unduly hamper their ability to serve their own
13 customers.

14 So, I think that that's just a
15 very important point that serves as really, an
16 extra back-stop here, you know, not
17 withstanding that the data is very clear, that
18 proposal itself is designed to address these
19 concerns.

20 With that, we would like to wrap
21 up and get to your questions. I am not going
22 to go through all of these again, because I

1 think I hit on almost all these points at the
2 outset.

3 But what I would like to leave you
4 with is, because you know, you're going to
5 hear in a few moments perhaps, that this is a
6 risky proposition and that you should not go
7 forward and make the changes that we're asking
8 you to change -- to make here today, and that
9 is just not the case.

10 This is not a risky proposition.
11 This is an opportunity. This is an
12 opportunity for this Board to take a
13 leadership role in fulfilling the promise of
14 Staggers that has not been fulfilled.

15 The intent of Congress is clear on
16 this reciprocal switching provision. It makes
17 absolutely no sense, that is has never been
18 used and has never been able to provide relief
19 to a single captive shipper in this country.

20 So, with that, we submit the
21 record is clear. We urge you to move forward,
22 to open a rulemaking on this proceeding.

1 There can be additional comments, additional
2 vetting on this proposal, and we submit to
3 you, to please do that. Thank you very much.

4 CHAIRMAN ELLIOTT: Thank you. Do
5 you want to --

6 VICE CHAIRMAN BEGEMAN: Thank you
7 very much. Could we start with perhaps, you
8 giving an overview as to how you developed the
9 proposal?

10 In example, why a 240 RVC ratio?
11 How were you able to convince your membership
12 that, "Boy, have I got a great deal for you,
13 less than five percent of traffic is going to
14 get competition."

15 It is sort of a mixed message, and
16 so, if you could just give some background to
17 pre-2011, when you submitted the proposal.

18 MR. DiMICHAEL: Commissioner
19 Begeman, let me maybe address that a little
20 bit.

21 We were very conscience in doing
22 this, that we were -- we're stepping on some

1 new ground here.

2 It would have been easy and kind
3 of, you know, politically easy, I guess, with
4 our membership to say, "Yes, we're going to go
5 for open access or we're going to go for
6 this."

7 But I think what we wanted to do
8 was to give you a proposal that was
9 reasonable, it was balanced, that seemed to
10 focus on problems, the problems dealing with
11 shippers who were truly captive.

12 So, if you kind of start from
13 there, let's not, you know, go for the world.
14 Let's go for where there is a problem, and we
15 can see how that works.

16 Then we began to think about,
17 okay, well, you know, what do we need to do to
18 develop that? What are some good indicia of
19 captive situations?

20 One indicia is high-market share,
21 and so, we began to look at well, what is a
22 market share that makes sense, that seems to

1 deal with captivity? Seventy-five percent,
2 the Courts have said a 70 percent market share
3 or more is a good indicia of captivity.

4 Cost, high R/VC ratios. The Board
5 itself has said a high R/VC ratio is a good
6 indicia of captivity. So, we were looking for
7 those kinds of things.

8 The second thing, I think we were
9 looking at, is to try to avoid a five-year
10 litigation, millions of dollars. We wanted
11 something that would work, that would be
12 simple, that is business-friendly, that's
13 competition-friendly, that would not bog
14 shippers and carriers down.

15 So, that is how the concept
16 evolved of looking at these conclusive
17 presumptions, trying to get things that were
18 pretty clear indicia of competitor problems
19 and pretty clear areas where you can say,
20 "Okay, well, this is on this side of the
21 fence, and that's on that side of the fence."

22 But we were also, as Ms. Booth

1 said at the very end, conscience of the fact,
2 look, safety is important. Operational
3 efficiency is important, and so, we wanted
4 then to look at things that -- we wanted to
5 have a back-stop, as Ms. Booth said, and so,
6 the fourth condition was the operational back-
7 stop.

8 So, as I said, it would have been,
9 you know, an easy thing and an easy message
10 for us to say, "Well, we're just going to go
11 for, you know, ever shipper within 40 miles,"
12 like they have up in Canada, but we didn't
13 think that that would be, in a sense fair.

14 It wouldn't be a thing where the
15 Board would feel comfortable frankly, in
16 taking a step that large.

17 This is a modest step, a step that
18 we can take slowly and see how it works.

19 VICE CHAIRMAN BEGEMAN: Can you
20 address 240 versus 300, or 500, versus RSAM,
21 versus limit price, and do you have a
22 breakdown by commodity?

1 MR. DiMICHAEL: Okay.

2 VICE CHAIRMAN BEGEMAN: So, is it
3 particularly helpful to chemical shipper?

4 MR. DiMICHAEL: It might be --

5 VICE CHAIRMAN BEGEMAN: It might
6 be in the record?

7 MR. DiMICHAEL: Yes.

8 VICE CHAIRMAN BEGEMAN: It may be
9 in the --

10 MR. DiMICHAEL: And I'm going to
11 definitely ask Jay to look at this.

12 But the 240, we thought that that
13 was a figure that was at the very high -- it
14 was higher than the highest captive -- higher
15 than the average captive traffic R/VC.

16 We looked at a traffic that was
17 higher than what -- than 180, and what is the
18 span of that traffic?

19 It goes from 180 percent to, you
20 know, 900 percent, and the Board itself
21 publishes a figure, the R/VC greater than 180,
22 which gives you that average. That average is

1 about 240.

2 We said, "Well, let's take a look
3 at the figures. Let's take a look as our
4 qualifying figure, a figure that is higher
5 than the highest -- than the average captive
6 traffic," and that then is going to be the
7 competitive -- excuse me, is going to be the
8 qualifying figure.

9 We have, I believe in the record,
10 the information about what commodities are.

11 MR. ROMAN: The appendix to my
12 testimony has it broken down by commodity
13 code, and coal would be the largest commodity
14 that's impacted, followed by chemicals, as you
15 would expect, when you look at the traffic
16 that moves on the rail system.

17 We did look at -- we did look at
18 the impact, when we used the RSAM R/VC's of
19 each railroad. Obviously, if we had a 180
20 percent R/VC, we would have more impacted
21 carloads, but the whole process from our
22 standpoint, in crunching the numbers and

1 taking a look at what was going to be
2 impacted, was you know, what is -- what is
3 logical for the STB to be accepting?

4 If we make the R/VC too low, it's
5 a bigger bite for the -- for you to bite off
6 from the STB.

7 So, Bruce can probably address,
8 I'm sure there is a lot of shippers that
9 weren't particularly fond of having a 240
10 percent R/VC versus a 180 percent R/VC.

11 But it was -- we're generating an
12 outcome that seems like it's not going to
13 adversely impact the railroads and it's
14 something that STB may feel more comfortable
15 with.

16 MS. BOOTH: Can I have just one
17 very quick follow up to that?

18 I just wanted to mention that the
19 proposal is also more flexible to allow for
20 relief beyond proof of the conclusive
21 presumption.

22 So, that was one way that we could

1 satisfy certainly, other shippers who have
2 concerns that they may be 35 miles away from
3 the interchange, and therefore, the conclusive
4 presumptions were designed to be what we call
5 the fast-pass.

6 If you can satisfy those, the
7 indicia is clear. The market power exists and
8 you should be entitled to relief.

9 If you cannot satisfy the
10 conclusive presumption, the opportunity should
11 still be there to meet the general parameters
12 of the NITL proposal, but it has to be
13 reasonable, and that would allow -- that would
14 have to be litigated, in a sense, and that
15 would be your decisions, as to whether or not
16 32 miles or 35 miles in the context of a given
17 case, should still qualify. So, I just wanted
18 to make that point.

19 VICE CHAIRMAN BEGEMAN: There
20 seems to be fairly large disagreement between
21 this panel and the next panel, in terms of
22 what the estimates are on the impact, 20

1 percent versus less than five percent.

2 Would the shipper community be
3 satisfied with a cap of up to 4.6 percent of
4 traffic impacts and wait to target -- make
5 sure the rail industry doesn't face a severe
6 crisis with service inefficiencies? You don't
7 really know what I'm asking?

8 MR. DiMICHAEL: Not quite.

9 VICE CHAIRMAN BEGEMAN: Well, I
10 mean, so, there is a cap on the number of --
11 instead of your estimate perhaps being too
12 small, but you're satisfied with up to 4.6
13 percent of traffic?

14 MS. BOOTH: If the Board were to
15 establish a cap.

16 MR. DiMICHAEL: Okay, a cap?

17 VICE CHAIRMAN BEGEMAN: It can't
18 be unlimited -- so that it can't --

19 MR. DiMICHAEL: Well, I think
20 those are the kinds of things that would be
21 well investigated, I think, in a -- on a
22 rulemaking, it's tough for me to say, well,

1 you know, 4.6 is --

2 MR. DiMICHAEL: -- going to be a -

3 -

4 VICE CHAIRMAN BEGEMAN: Could, I'm
5 sorry, I'm kind of monopolizing this--

6 Could one of you sort of just walk
7 through the basic mechanics from a shippers'
8 perspective of how this actually would work?

9 I mean, you know, get on the
10 phone, I want to do x', and then you have to
11 kind of deal with the fact that if a carrier
12 is objecting to it, and wants to discuss the
13 inefficiencies or the safety --

14 MR. DiMICHAEL: I would then --

15 VICE CHAIRMAN BEGEMAN: -- is
16 every case coming here?

17 MR. DiMICHAEL: No, I mean, I
18 think this is -- this starts out, and frankly,
19 should end as a business position.

20 What I would kind of see here, in
21 the real world, and you asked about the real
22 world, what I would see here is shippers

1 taking -- you know, sitting in his office and
2 says, "You know, there is a carrier seven
3 miles away that I'd really like to have access
4 to, and I think it would be good for my
5 business," etcetera.

6 Well, what I sort of see here is
7 the first thing he does is to call up his rail
8 carrier and says, "You know, the rates you're
9 charging me are too high and I really want
10 something less," and then there is, you know,
11 a back and forth with that.

12 If the shipper doesn't get, you
13 know, satisfaction there, then probably what
14 the shipper will do is to say, "Well, you
15 know, there is this process at the STB about
16 competitive switching, but instead of going
17 through all of that, will you just grant me
18 competitive switching and we'll just say there
19 is going to be an access fee of -- let's agree
20 on an access fee of x', and so, we'll just
21 let the thing handle."

22 If the carrier says no to that,

1 the what I would see at that point is, the
2 shipper would submit a fairly concise pleading
3 at the STB, saying, "I'm served by a single-
4 rail carrier. That rail carrier is x'. My
5 R/VC ratio is 272 percent for this move
6 between Point Y and Point Z, and here is the
7 URCS calculations that show that, and I am
8 seven miles from the other carrier, and here
9 is the map."

10 Then at that point, a shipper
11 submits that and he has made the prima facie
12 showing.

13 At that point, the railroad can
14 then come to the Board and say, "Well, even
15 though the shipper has made this prima facie
16 showing that he is within 30 miles and is more
17 than 240 percent and is served by a single
18 rail carrier, I am telling you, Board, that
19 doing competitive switching in this case is
20 going to mess up my service."

21 "It's going to clog my yard. It's
22 going to mess up my service to the three or

1 four other shippers who are involved."

2 At that point, then the Board
3 would have to decide, but that is a fairly
4 concise, fairly quick kind of process before
5 the Board, which I would hope that you would
6 not even get to because the parties are able
7 to deal with this on a good business basis.

8 That's how I kind of see this
9 thing working out in a practice.

10 If a shipper is, as Ms. Booth
11 said, outside of the 30 miles or has a, you
12 know, 220 percent R/VC ratio, that shipper
13 can't qualify conclusively, automatically, and
14 so, therefore, the shipper would have to come
15 to the Board with a more robust showing,
16 saying, "Look, even though I'm 35 miles, it's
17 fair for me to get competitive shipping," and
18 you may -- and then the Board will have to
19 decide, is 35 miles a reasonable distance, and
20 is 220 percent, you know, okay? That's how I
21 kind of see the whole thing working.

22 But the idea here is not to have a

1 millions of dollars, five-year litigation over
2 this. It should be something that should be
3 business-friendly, simple and quick.

4 VICE CHAIRMAN BEGEMAN: My last
5 question for now, and is probably best
6 directed to you, Karyn.

7 One of the slides that you jumped
8 over, because of timing, actually is an issue
9 of real concern to me, which is, what about
10 the captive shippers that don't qualify under
11 this?

12 I guess you guys have touched on
13 it a bit in this last dialogue, that you're
14 not trying to completely shut them out and you
15 want them to be able to make a presentation,
16 but effectively do their rates go up?

17 MS. BOOTH: We certainly don't
18 believe so, and we've certainly submitted
19 evidence on that point, in our filings.

20 But what we had planned to talk to
21 you about is, well, we've included -- there
22 seems to be even disagreement amongst the

1 railroads on that issue.

2 I think it was UP itself, in its
3 comments indicated that shippers who don't
4 qualify are not likely to incur rate increases
5 because the railroads currently have every
6 incentive today to charge the shippers the
7 rates they can in the market.

8 So, that issue, we're not frankly
9 concerned about. We don't believe that it's
10 going to result in drastic rate increases for
11 other shippers, and we also don't believe that
12 they're going to incur service problems, which
13 have been alleged, and that's for the reasons,
14 as we explained, that we just don't believe
15 the operational impacts and problems that are
16 claimed will occur, are going to occur.

17 You know, in addition to that, I
18 think the railroads make the point that, you
19 know, this CSP results in winners and losers
20 and the Board shouldn't be put in the position
21 of picking who those are.

22 But unfortunately, that is the

1 system we have, and that's that status quo.

2 I mean, I think today, if you look
3 at exempt shippers versus non-exempt shippers,
4 well, some might call some winners and losers,
5 depending upon, you know, the point in time,
6 and what the market conditions are. Those
7 exempt shippers can't come to you today for
8 relief.

9 If you look at the differential
10 pricing today, you might say there are some
11 winners and losers.

12 So, we had to make decisions in
13 how this proposal would be designed. We think
14 it's fair. We think it's balanced and we
15 don't think that it will harm shippers who
16 don't qualify.

17 MR. ROMAN: I think it could also
18 be referenced. When you look at the -- in
19 practice, what happens in negotiations between
20 shippers and railroads, you have a lot
21 movements, let's say that -- that aren't
22 impacted.

1 But a lot of companies are going
2 to have movements that some movements aren't
3 impacted and some movements are impacted, and
4 your ability as a shipper to negotiate your
5 whole rate structure with the railroad is
6 predicated upon how much competitive traffic
7 I actually have.

8 So, if I am a shipper, I have a
9 greater potential to be negotiating better
10 rates for my captive traffic, if I have 20
11 percent of my traffic competitive, instead of
12 15, because I'm putting more traffic at risk.

13 So, for an awful lot shippers,
14 even the movements that aren't impacted, a
15 shipper can have greater leverage in
16 negotiating better rates for those, or
17 preventing big rate increases in those,
18 because as the CSP could create more
19 competitive traffic for them, they'd have
20 greater negotiating leverage with the
21 railroad.

22 CHAIRMAN ELLIOTT: Thank you, Vice

1 Chairman. I have just a few questions. My
2 first question is probably also more of a
3 legal question.

4 With respect to the statute
5 itself, I read it to require, based on the
6 language, that if there is such an arrangement
7 put in place, that the carriers would have to
8 negotiate a rate first, and then if within a
9 reasonable amount of time, they could not
10 reach an agreement, then they would have to
11 come to us.

12 I know that was raised by several
13 railroads, but I don't know if it was
14 addressed in the shippers or NITL's pleadings,
15 and I was just wondering if you could comment
16 on that reading of the statute.

17 MS. BOOTH: Mr. Chairman, we agree
18 with your reading of the statute. That is
19 what the statute happens to say. I do have it
20 here with me.

21 I think for the purpose of this
22 proceeding, of course, you asked for an

1 assumed methodology for access pricing, which
2 we did, so that we could do the calculations.

3 But we are not here today or in
4 our CSP rulemaking petition, asking you to set
5 the switching fees specifically as is done
6 under the Canadian system.

7 However, we have set forth certain
8 principles in our filing that we do think are
9 important, relative to the access fee issue,
10 and we do believe that you have the authority
11 and powers to potentially set certain
12 guidelines or principles on that point,
13 without actually setting a rate.

14 We know that the railroads would
15 like access fees to be put in place that would
16 include lost contributions, so to speak, such
17 that there really would be -- the incumbent
18 carrier would really be made entirely whole.
19 There would be no rate reduction, in essence.

20 You know, our view of that is that
21 that would gut, you know, the entire point of
22 adopting a competitive switching regime and

1 proposal here.

2 So, our view is that switch fees
3 should be cost based to allow for perhaps, a
4 reasonable level of contribution of a variable
5 costs, similar to what's done in Canada, and
6 that you could perhaps, set some principles in
7 that area, without actually setting the fee
8 itself.

9 CHAIRMAN ELLIOTT: And let's say
10 we go forward with such a proposal, and that
11 is how we read it, and then the carriers set
12 whatever rate it is for the switching fee, and
13 then maybe we do come up with some guidelines,
14 but the Court, because it will go up on
15 appeal, will say, "You know, this statute is
16 extremely clear," and if the railroads adopt
17 some kind of switching fee, which I assume has
18 to be reasonable, then you know, that's where
19 you have to keep the price.

20 I mean, like you said, if it is
21 something like an efficient component pricing
22 type fee, that would gut your idea here today,

1 and I'm just concerned that if that's where we
2 end up, then we may be going through a process
3 for no reason.

4 MS. BOOTH: Well, I think in that
5 circumstance, it would be unfortunate if the
6 railroad behavior turned out to be entirely
7 consistent in that vane, across this country.

8 I think it's our hope that there
9 will be opportunities that will incentivise
10 rail carriers to actually vigorously compete
11 for switching traffic and set fees that are
12 reasonable. That is our hope. Maybe it's a
13 dream.

14 We have, you know, other shippers
15 who are very concerned that the railroads
16 won't vigorously compete and can defeat this
17 by setting fees that high.

18 I guess if that happens, the
19 remedy is a rate case on the switch fee that's
20 set, so there is another opportunity.

21 It's not certainly a path that
22 many shippers like to go down. It's too

1 costly, to expensive, etcetera. We're not
2 going to get into the debate on rate cases
3 here.

4 But that is how we see this
5 potentially working.

6 CHAIRMAN ELLIOTT: Thank you. A
7 couple other questions -- these are more so
8 I kind of understand your proposal completely.

9 On the 30 miles, is that track or
10 radius, because I think the railroads raised
11 some good points, with respect to why a radius
12 might not work well versus track miles.

13 So, I didn't know if you, after
14 reading through your pleadings, if you had
15 take a set position on that, at this point.

16 MS. BOOTH: The NITL proposal was
17 designed with a 30 mile radius. So, it was
18 radial miles.

19 For the purpose of this
20 proceeding, and in conducting the analysis
21 that Mr. Roman performed, we did use rail
22 miles in distance.

1 I think that our view is that the
2 radial miles would be, you know, simple and
3 easier to apply. When Jay got into his
4 analysis, and he can speak to this, there were
5 some anomalies that showed up in that vane,
6 and so to simplify things on the study, we did
7 use rail miles.

8 We think that this is an issue
9 that again, could be vetted in a rulemaking,
10 you know, where there could be more direct
11 commentary on that point, but for purposes of
12 this proceeding, we had to pick one or the
13 other, and rail miles turned out to be
14 simpler.

15 MR. ROMAN: One of the issues with
16 radial miles, as the crow flies, you can have
17 some movements that can be, let's say, 10 or
18 20 miles away from a working junction, from a
19 captive station, but in rail miles, they can
20 be more than 100 miles.

21 We applied a set switch fee, under
22 our analysis, and for using the set switch

1 fee, we had under our analysis, it looked like
2 it was more reasonable to be using the rail
3 miles.

4 However you look at the miles,
5 there is -- when you get into the weeds, there
6 is always some problems with it, and one of
7 the problems in our calculations, we're using
8 the waybill and the waybill doesn't get to the
9 industry. The waybill gets to the closest
10 station to the industry.

11 So, when you're looking at mileage
12 distance, there is this thing of local miles,
13 and we have mileage in our analysis for 30
14 miles from the captive station. When you
15 actually calculate those miles from the
16 industry, we could very likely have some
17 movements that fall out and are not within the
18 30 mile range.

19 So, it's a question of when you're
20 getting into the miles, as Karyn said, it's
21 probably best to have that as a focal point in
22 the decision from STB, as to which miles

1 should actually be used, because is different
2 details in both sides of it.

3 CHAIRMAN ELLIOTT: Another
4 question. With respect to the service issues,
5 obviously, the railroads have raised quite a
6 large amount of concern about possible service
7 issues, and you addressed that extreme route
8 well, and I thought the Vice Chairman also had
9 an interesting idea on a cap.

10 But one thing I was wondering
11 about is, would it be possible to create a
12 safe harbor that would permit the railroads to
13 avoid entering into a reciprocal arrangement,
14 so if you have the 240 number, and let's say,
15 if any rate below that R/VC ratio, if any rate
16 falls below that, at that point in time -- if
17 it's above it, the railroads could quote you
18 a rate below it, and then they would come into
19 a safe harbor, and then they wouldn't have to
20 engage in a reciprocal switching, which would
21 cause their service concerns to go away,
22 because then they would control the game.

1 So, if they really believe, and
2 they are correct, that there will be severe
3 service problems as a result of this, they
4 could just lower their rates below the 240
5 number to 239, and as a result, some of these
6 service issues that I'm sure concern everyone,
7 including the shippers, because nobody wants
8 to mess with the railroad system, would be
9 eliminated automatically.

10 Do you have any thoughts on an
11 idea of that nature?

12 MR. DiMICHAEL: Let me just take a
13 quick whack at that.

14 The conclusive presumption applies
15 only to 240 or above. So, if it's less than
16 240, the only way you'd get competitive
17 switching is by coming to the Board and
18 litigating.

19 The railroads can always avoid
20 that, by simply entering into a contract at
21 something less than 240, and then they'd get
22 the shippers business and they could keep it.

1 So, in the scenario that I was
2 describing to Commissioner Begeman before, I
3 would think that part of this is that in these
4 initial discussions the railroad has the
5 opportunity to say to the shipper, "Look, you
6 don't have to go there. We'll just enter into
7 a contract at a rate that is less than 240 or
8 acceptable to you, and we're done."

9 CHAIRMAN ELLIOTT: Thank you.

10 VICE CHAIRMAN BEGEMAN: That
11 doesn't change the 75 percent cap.

12 CHAIRMAN ELLIOTT: Yes, I'm
13 assuming out the 75 percent right now, based
14 on that safe harbor.

15 MR. DiMICHAEL: Right.

16 CHAIRMAN ELLIOTT: Thank you for
17 the clarification.

18 One other question that I guess
19 I'd be remiss if I didn't ask.

20 With respect to the section that
21 we're referring to again, there is a section
22 which references the possibility of labor

1 protection, and I think the railroads did
2 address that, to some extent, and I didn't
3 know what your position was, with respect to
4 how that provision of the statute should be
5 handled.

6 MS. BOOTH: Mr. Chairman, we
7 haven't specifically addressed, you know, that
8 provision in the statute, but I think that
9 from our perspective again, it would be
10 appropriately raised in the rulemaking.

11 If this Board had particular
12 concerns or issues or proposals that it would
13 want to make, relative to that specific
14 provision, that would be an appropriate place
15 to do so, and you know, the League would be
16 very glad to address any of those points in
17 any comments that we would make.

18 But we certainly would not want to
19 -- I guess I can add, have our proposal, you
20 know, adversely impact labor issues, and
21 that's why I think the rulemaking would be the
22 right place to raise any of those concerns,

1 and we could fully respond.

2 CHAIRMAN ELLIOTT: Thank you. One
3 last question.

4 I was looking at what the Vice
5 Chairman was mentioning in her last question,
6 and in your third slide, you show the rates
7 increasing, what appear to be significantly on
8 this chart.

9 Does that chart show that the
10 railroads have the ability to price going
11 forward, and as a result, that would raise
12 some concerns with the issue about the
13 transferring of the money from one captive
14 shipper to another, that is not subject to the
15 reciprocal switching proposal?

16 I guess I'm not sure who that
17 would be best for -- I just have some concerns
18 about the way the rates are going up, and it
19 seems like the argument, you reference UP's
20 argument, that they're already getting every
21 nickel that they can possibly get, that just
22 makes economic sense.

1 But it seems like they've been
2 able to price higher going forward over the
3 last nine years, and I just wonder if that
4 would raise any concerns that the railroads
5 would have the ability, if they do lose money
6 as a result of this proposal, that they would
7 transfer it to other captive shippers that
8 don't have the benefit of this, like --

9 MS. BOOTH: I guess it would just
10 be repeating what we said earlier.

11 I mean, our view is that we think
12 that is not likely to happen, that that would
13 be a low risk.

14 I suspect if it did happen, and
15 the non-qualifying shippers would have to look
16 at a rate case or something of that sort.

17 But our view is that we don't
18 believe that that's a high risk proposition.

19 MR. ROMAN: I would add to that.
20 As a part of my testimony, we had the rail
21 station captivity map, which had the number of
22 stations that were captive in each state, and

1 there is -- it shows that there is close to 80
2 percent of all rail stations are captive to
3 one class on the railroad.

4 The intent of the CSP is to try to
5 reduce that from being 80 percent, and the
6 idea is to create more competitive traffic,
7 which will give many companies the ability to
8 put more traffic at risk, to be -- and that
9 can influence their ability to negotiate
10 better rates for captive traffic.

11 If the railroads would seize this
12 as it -- because they have to give out better
13 rates to one company and then they would
14 increase their rates to another company, that
15 would have -- also have ramifications for the
16 railroads.

17 I mean, if that happened, there
18 might -- have more situations where companies
19 would file a rate case, because their -- the
20 question is, how high can a rate go, and if
21 the railroads did attempt to just take that
22 out on the captive traffic, there are other

1 things that shippers can do to try to bring it
2 back in line.

3 MR. DiMICHAEL: The only other
4 thing I would say, Mr. Chairman, on that, UP
5 said in its testimony, and I quote, "UP
6 already has every incentive to price traffic
7 to maximize contribution."

8 I think the implication of that
9 is, if they can get more out of the traffic,
10 if this proposal exists, or whether it does --
11 they will attempt to maximize contribution
12 whether this proposal exists or not.

13 So, it's going to happen in the
14 sense, anyway. This proposal will hopefully
15 provide a competitive counterweight.

16 VICE CHAIRMAN BEGEMAN: Just to
17 follow up on one thing I said, and then to ask
18 maybe one final question.

19 But I wasn't necessarily floating
20 the idea of capping, putting it -- but I was
21 under -- trying to understand, would you be
22 satisfied that adding competition for 4.6

1 percent of traffic is a game-changer, is
2 enough? A starting point? An ending point?

3 I know that someone will accuse me
4 of getting a billion dollar check written to
5 you, but that's not what I am advocating here.

6 MR. CARLTON: I am tempted to
7 discuss the billion dollar check that Mr.
8 Buffet was offering, but my bracket was busted
9 on the first night.

10 So, not to be flip, yes, I mean, I
11 think that, you know, the injection of
12 competition that we have described through
13 this modest proposal is a wonderful beginning.

14 You know, we recognize the nature
15 of the industry. We understand how the
16 industry operates. We understand how some
17 shippers have more competitive advantage than
18 others.

19 But this is a step in the right
20 direction, and if the numbers work out to 4.6,
21 3.7, 5.2, well, then so be it.

22 You know, I don't really think we

1 want to be governed by that consideration. I
2 think we want to come at it from the other
3 direction, which is why don't we try to build
4 a mechanism into this apparatus that
5 encourages competition, that encourages the
6 incumbent carrier, frankly, to say, "I want to
7 keep your business. Let's talk about service
8 levels. Let's talk about pricing. Let's talk
9 about other matters, because I don't want to
10 give you up."

11 That, for a shipper, who is
12 otherwise facing a 100 percent captive
13 situation, that's a win. That's a win, and
14 it's not a loss for the incumbent.

15 You know, without getting, you
16 know, artsy about it, I mean, that's the way
17 competition is suppose to work. That's the
18 way the rest of the economy works. That's the
19 way most shippers deal in their market place,
20 and we're just trying to -- you know, bring
21 that back as a consideration in this rather
22 unique and interesting market place of freight

1 rail.

2 VICE CHAIRMAN BEGEMAN: My last
3 question really is prompted by several of the
4 responses that you provided to the Chairman,
5 on his questions. "Well, we could bring a
6 rate case."

7 You know, that is a question
8 brought forth in the record. If this would go
9 forward, can you bring a rate case or do you
10 have competition?

11 So, I think that is something that
12 all the parties really need to talk about.

13 I realize what your desire is, but
14 I think it certainly is an important issue
15 that would have to be dealt with.

16 MS. BOOTH: With respect to that
17 point, you know, our view, and I believe it's
18 been clearly stated in our filings, is that we
19 do not view this competitive switching
20 proposal and outright foreclosure of the
21 shippers opportunity to bring a rate case.

22 You know, rate case options and

1 switching options, we believe are two
2 independent remedies that exist in the
3 statute, that the shipper should have choice.

4 Now, if a shipper goes down the
5 path of pursuing competitive switching and
6 obtains competitive switching, then whether or
7 not they can bring a rate case, whether that
8 is effective competition becomes a question in
9 the context of a market dominance
10 determination.

11 If they pursue switching and the
12 switch rate offered to them is so high, that
13 they can't use the switching option, is that
14 effective competition?

15 Those are questions -- and we
16 believe it would not be and should never
17 foreclose the opportunity to otherwise then
18 bring rate case.

19 So, I agree with you, it's a very
20 important issue. I think shippers are very
21 concerned about that. You know, this intent
22 here is not to foreclose any other potential

1 remedies that may exist. We don't believe it
2 does so, but there may be factual
3 circumstances, once switching is pursued,
4 where that has to be evaluated in the context
5 of market dominance.

6 CHAIRMAN ELLIOTT: One last
7 question. As far as the overall proposal, I
8 think Ms. Booth described this very well
9 earlier, about winners and losers and that's
10 kind of how the system is set up already, with
11 respect to who has competition and who
12 doesn't.

13 And in this situation, it seems as
14 if whoever would benefit from this, just has
15 to be within 30 miles of the interchange, and
16 obviously, shows that there is market
17 dominance involved.

18 One concern I have is that that
19 does seem somewhat arbitrary, that these
20 people that we are selecting, if we go forward
21 with this proposal, are just selected on a
22 basis, which does not seem to be tied to

1 anything.

2 I was wondering, you mentioned, I
3 think in your filings, that the rail industry
4 appears to be healthy, much healthier than it
5 was obviously, when the Staggers Act was put
6 in place, and part of your argument is, things
7 have changed.

8 With that being said, what if we
9 looked at your proposal and then tied it in
10 some manner, to revenue adequacy and whether
11 or not a railroad's revenue is adequate?

12 So, in that situation, these types
13 of proposals would apply, if a railroad, based
14 on some of our precedent, would not need as
15 much differential pricing in that situation?
16 Would that be something that you would be
17 interested in exploring?

18 MR. DiMICHAEL: I think the
19 overall focus of this should be on shippers
20 who have -- who are in a sense, the most
21 captive, and the -- and the proposal is
22 suppose to focus really on that, and I just

1 want to clarify maybe one thing, that the 30
2 miles is the conclusive presumption, but there
3 is an opportunity for people who are somewhat
4 outside, to be able to do that.

5 So, I don't think this is a
6 problem, in terms of arbitrariness. There is
7 lots in the record also, showing that the 30
8 miles makes a fair amount of sense.

9 The Boards are -- the committee,
10 you know, actually gave you that -- that
11 actual mileage figure.

12 Just as a rate case is not focused
13 on purely revenue adequacy, you can bring a
14 rate case against a revenue inadequate
15 carrier, if it's -- that carrier is charging
16 too much.

17 It seems to me, that should be the
18 same kind of focus here. It should be really
19 on captivity and competition, but I think we
20 can certainly say, the rail industry right now
21 is in a very, very, very different financial
22 situation than it was in 1978 or 1980, or for

1 that matter, even in 1990 or even in 2000.

2 So, it seems to us that you can go
3 forward confidently, because you're dealing
4 with a rail industry that is financially
5 strong.

6 CHAIRMAN ELLIOTT: Thank you very
7 much for that. We really appreciate you coming
8 today and presenting your position. Thank
9 you.

10 MR. DiMICHAEL: Thank you very
11 much.

12 MS. BOOTH: Thank you.

13 CHAIRMAN ELLIOTT: Okay, I think
14 we're now at Panel III.

15 Just for planning purposes and
16 possible flights this afternoon, although I
17 can't believe anybody would leave and not
18 watch tomorrow's performance, we intend to
19 just keep working through. So, I just want to
20 let you know that, and in case you're starving
21 or something like that.

22 But that is our plan, at this

1 point in time.

2 So, we are going to begin with
3 Panel III, and I believe that we will start
4 with the Association of American Railroads,
5 who has 50 minutes.

6 MR. SIPE: Thank you, Mr.
7 Chairman, Vice Chairman Begeman. Good to be
8 here this morning.

9 My name is Sam Sipe. I'm Counsel
10 for the AAR in this proceeding.

11 AAR is very pleased to have an
12 opportunity to talk to the Board Members face-
13 to-face about this important proposal, and we
14 look forward to having an opportunity to
15 respond to your questions, as well.

16 I'm going to take a moment at the
17 beginning, to summarize AAR's key points, and
18 where is our slides meister?

19 That's us, Association of American
20 Railroads, and these would be our key points.

21 What I'm going to do is, as I
22 mention these key points, is introduce the

1 various members of the AAR Panel, who will
2 speak to the specific points here.

3 After my colleagues have made
4 their presentations, I will offer some
5 concluding remarks.

6 Our first point is that analysis
7 of the impact of the NITL proposal must start
8 with the fact that the proposal is vague and
9 incomplete.

10 We've already had some questions
11 this morning about how would this thing
12 actually work, and my reaction to what we
13 heard was, that was kind of incomplete, as
14 well.

15 The fact is, as we sit here now,
16 we really don't have any clear sense of how
17 that would work.

18 There is also an issue with the
19 modeling that has been done, and the reality
20 is that NITL and the other commenters have not
21 been able to accomplish the Board's objective
22 in this proceeding, which was to determine

1 with some precision, the impact of the NITL
2 proposal on railroads and shippers.

3 Making matters worse, the parties
4 supporting the proposal failed to model key
5 aspects of the NITL proposal.

6 AAR's first witness, Michael
7 Baranowski of FTI Consulting, addresses the
8 parties impact analyses, and explains that
9 even with the uncertainties in the proposal,
10 it's clear that the NITL proposal could
11 potentially affect a very substantial number
12 of carloads, and I want to put the emphasis on
13 the word potential, because we don't know with
14 precision, but we've told you what the
15 boundaries of possible impact is, and as the
16 Board thinks about this proposal, you need to
17 recognize that it's not a pinpoint estimate,
18 it's a range, and nobody can tell us what's
19 going to happen.

20 Regarding our second and third
21 points, William Rennicke of Oliver Wyman will
22 address the two serious risks that are raised

1 by the NITL proposal.

2 Mr. Rennicke will explain why the
3 proposal poses the risk of potentially serious
4 service disruptions that would harm railroads
5 and shippers alike, including those captive
6 shippers who wouldn't benefit from the
7 proposal.

8 He will also address the adverse
9 effect of the NITL proposal on railroad
10 infrastructure and investment.

11 The risks discussed by Mr.
12 Rennicke are not offset by any public
13 benefits, as explained by AAR's next speaker,
14 Dr. Kelly Eakin of Christensen Associates.

15 Dr. Eakin will address economic
16 aspects of the NITL proposal, including the
17 likelihood that the proposal, if adopted,
18 would produce winners and losers among
19 shippers.

20 Dr. Eakin will be followed by Phil
21 Ireland, a former officer of Canadian Pacific
22 Railroad.

1 Mr. Ireland will explain why
2 Canadian inner-switching does not provide a
3 reliable basis for comparing the situation in
4 Canada with the situation that might obtain in
5 the U.S. under the NITL proposal, and he will
6 explain why NITL's predictions of the level of
7 mandatory switching, based on the Canadian
8 experience, are completely unreliable.

9 At the conclusion of these witness
10 statements, I will explain why the Board
11 should terminate this proceeding, without any
12 further steps.

13 With that, I'll turn it over to
14 Mr. Baranowski.

15 MR. BARANOWSKI: Thank you, Mr.
16 Sipe. Thank you for the opportunity to
17 testify as part of the AAR Panel.

18 My name is Mike Baranowski. I'm a
19 Senior Managing Director for FTI Consulting in
20 Washington, D.C., and head of the firm's
21 network industry strategies practice.

22 I, along with my colleague Rick

1 Brown, submitted opening and reply verified
2 statements in this proceeding. I am here
3 today to provide an overview of my opening
4 reply testimony concerning the potential scope
5 of the NITL proposal, to discuss the empirical
6 analysis conducted by other parties, and to
7 answer any questions that the Board may have
8 regarding my testimony.

9 Our written testimony and my
10 discussion today make two basic points.

11 First, there are data limitations
12 and ambiguities in the NITL proposal that make
13 it impossible to determine with any precision,
14 the number of carloads that would be covered.

15 In fact, as I noted in my written
16 testimony, the NITL proposal is more of a
17 concept than a proposed rule. It is also
18 impossible to predict accurately, how
19 railroads and shippers would respond in
20 particular instances to the availability of
21 mandated access.

22 Never the less, the potential

1 scope of the NITL proposal is very broad. The
2 available data show that the NITL proposal
3 could potentially affect more than one-third
4 of the non-inter-modal carloads.

5 Second, NITL and other commenting
6 parties that support the NITL proposal did not
7 attempt to identify the potential scope of the
8 proposal that is before the Board.

9 NITL's analysis ignored many of
10 the features of its own proposal and applied
11 unsupported and self-serving predictions about
12 how railroads and shippers would respond to
13 mandated switching rules, both of which
14 minimize NITL's estimates of the overall
15 potential effects.

16 The result is a significant
17 disconnect between the terms of the NITL
18 proposal and its quantification of the
19 proposed effects.

20 As Figure One, which is projected
21 on the screen, or will be, shows my analysis
22 estimates that the NITL proposal could

1 potentially affect 7.5 million carloads
2 annually, while NITL claims that just over
3 one-million carloads would be affected.

4 It is necessary to start any
5 discussion of the impact of the NITL proposal
6 with the specific provisions of the proposed
7 rule.

8 The NITL proposal would
9 conclusively treat traffic at single-serve
10 stations within 30 miles of a working
11 interchange as eligible for mandatory
12 switching if its rate -- either if its rate
13 was above 240 percent R/VC or if 75 percent of
14 the traffic for a given commodity between a
15 given origin and destination moves by rail.

16 My analysis used reasonable
17 assumptions to model the impact of the
18 proposed rule as NITL proposed it, and this
19 required taking account of NITL's 75 percent
20 provision.

21 The 75 percent provision in NITL
22 proposal means that many more than simply

1 those carloads with R/VC's above 240 percent
2 at single-serve stations would be eligible for
3 mandatory switching.

4 Specifically, I considered all of
5 non-inter-modal carloads from single-serve
6 stations within 30 miles of a working
7 interchange as potentially affected, with the
8 exception of carloads originating and
9 terminating at a railroad owned special
10 facilities.

11 My estimate is conservative, in
12 that it does not account for the likely large
13 additional number of carloads from sole-serve
14 customers, customer facilities located at
15 stations served by more than one railroad.

16 As the Board knows, many rail
17 stations that are served by more than one
18 railroad have individual shippers located on
19 the lines of only of those railroads serving
20 the station.

21 In many of these cases, the
22 shipper does not have access to the other rail

1 carrier serving the rail station.

2 Under NITL's proposal, such
3 shippers would be able to obtain mandated
4 switching, but there is no feasible way of
5 using the available data to determine how many
6 shippers fall into this category. So, my
7 scope estimate is necessarily under-stated,
8 and potentially by a large amount.

9 On opening, NITL ignored important
10 features of its proposed rule and made
11 numerous unfounded assumptions to reduce its
12 potential scope.

13 Figure 2 quantifies the number of
14 carloads that NITL dropped from consideration
15 by virtue of data screens it deployed. I will
16 now address each of those data screens.

17 The first reduction in Figure 2,
18 reducing the number of potentially affected
19 carloads from 7.5 million to 5 million is the
20 result of a series of non-revenue screens used
21 by NITL. These include eliminations of
22 carloads from stations on KCS, CN and CP.

1 Exclusion of all carloads where
2 more than 30 rail miles from the interchange,
3 even though NITL proposes to establish a 30-
4 mile radius.

5 Limiting the definition of
6 workable interchanges to only those locations
7 identified in the waybill sample as having
8 interchange traffic in 2010.

9 Exclusion of any carload that
10 would be able to use force switching at an
11 origin or destination, but would remain closed
12 at the other end. There is no basis in the
13 NITL proposal for any of these reductions.

14 The second group of reductions
15 shown in Figure 2 are the results of three
16 revenue screens applied by NITL. Like the
17 non-revenue screens I just described, the
18 revenue screens are not consistent with the
19 language of the NITL proposal, yet they
20 further reduce NITL's estimate of potentially
21 affected traffic from 5 million carloads all
22 the way down to 1 million carloads.

1 First, NITL excluded all carloads
2 that have an R/VC below 240, which is contrary
3 to both the 75 percent rule of the NITL
4 proposal and the provision in the proposed
5 rule, allowing shippers to obtain forced
6 access if they can show market dominance,
7 regardless of the R/VC ratio of the movement.

8 Second, NITL applied a screen that
9 is based on speculation about the level to
10 which rates would fall under a forced access
11 regimen that eliminates the number of
12 shipments with R/VC's over -- that eliminates
13 a number of shipments with R/VC's over 240
14 percent from consideration.

15 NITL assumes in effect, that
16 railroads would never set a price below an
17 arbitrary assumed average competitive price in
18 order to obtain new business.

19 Third, NITL takes its speculation
20 about railroad pricing behavior one step
21 further by applying another revenue screen
22 that reduces potentially affected carloads

1 based on an assumption that forced access
2 would lead it -- lead to what it describes as
3 duopoly pricing.

4 The method by which NITL
5 establishes this supposed duopoly price is far
6 to convoluted to address at this hearing, but
7 the basic flaw is that there is no credible or
8 reliable way of predicting how railroads would
9 price their service in response to the
10 prospect of forced switching.

11 The last set of adjustments shown
12 in Figure 2 actually increase slightly, NITL's
13 count of carloads potentially affected by the
14 proposal.

15 Specifically, on opening, NITL did
16 not include any estimate of the carloads that
17 would be affected by its 75 percent rule.

18 On reply, it acknowledged its
19 prior failure to address the 75 percent
20 provision and created and submitted a new
21 methodology that supposedly assessed the
22 impact of the provision.

1 The approach is entirely without
2 foundation and as shown in Figure 2, adds back
3 only a small number of carloads compared with
4 the millions of carloads dropped from NITL's
5 analysis by first ignoring that provision.

6 While less convoluted than the
7 analyses submitted by NITL, the impact
8 estimates presented by US DOT, USDA and NGFA
9 also fail to assess meaningfully, the
10 potential impact of the NITL proposal.

11 For example, US DOT's estimate
12 evaluated only a subset of the commodities and
13 a subset of the railroads. It also looked
14 only at single-line movements and movements
15 with R/VC ratios above 240 percent.
16 Similarly, USDA and NGFA limited their
17 analysis to agricultural shippers.

18 Because these analyses did not
19 attempt to model the NITL proposal, their
20 impact estimates do not assist the Board in
21 assessing the potential scope of the proposal.
22 Thank you very much.

1 MR. RENNICKE: I am William
2 Rennicke, a partner with Oliver Wyman, a
3 management consulting firm that specializes in
4 transportation strategic planning. I've been
5 a railroad executive of Class I railroads and
6 a consultant to railroads for more than 40
7 years.

8 I submitted a verified statement
9 and reply verified statement for this
10 proceeding on March 1st and May 30th, 2013.

11 Today, I will elaborate on three
12 points I made in my prior statements.

13 First, that forced switching would
14 adversely affect rail operations and service
15 quality. Second, that forced switching would
16 severely restrict the railroad's ability to
17 make needed infrastructure investments and
18 third, that NITL has presented no
19 justification for imposing the adverse effects
20 of service disruption and reduce
21 infrastructure investment in the railroads or
22 the shippers.

1 Forced switching would adversely
2 affect rail operations and service quality.

3 A focus of my opening testimony to
4 the Surface Transportation Board on this
5 matter was the potential for forced switching
6 to lead to a wide ranging disruption of rail
7 operations and the deterioration of service
8 quality.

9 In fact, shippers have implicitly
10 acknowledged that if forced switching were to
11 become widespread, rail operations would be
12 adversely affected.

13 NITL claims the Board need not be
14 concerned about the impact of forced switching
15 on rail operations because they will rarely
16 occur. Yet, NITL is aggressively seeking the
17 right to compel railroads to switch, and
18 shippers claim that the threat of switching
19 would lead railroads to substantially lower
20 their rates to hold onto business.

21 Obviously, for the threat of
22 switching to have this impact, a significant

1 amount of switching must occur. Thus, the
2 Board has to assume that if shippers get the
3 right they are seeking, they will use it.

4 AAR and its member railroads are
5 the only parties in this proceeding that have
6 presented evidence showing what would happen
7 to rail operations if a significant amount of
8 additional switching were to result from a new
9 forced switching regime, and NITL has offered
10 no evidence to the contrary.

11 As I have shown, the effects of
12 forced switching could be well severe and
13 widespread.

14 As Exhibit 1 demonstrates, the
15 reduction of interchanges in the railroad
16 industry over the past 35 years is highly
17 correlated with improvements in rail
18 productivity.

19 NITL and Mr. Schuchmann's
20 statement does not deny that the reduction of
21 the number of interchanges has greatly
22 improved operating efficiency, yet Mr.

1 Schuchmann would have the Board ignore the
2 fact that the reduction in interchanges has
3 been among the most important, if not one of
4 the most important drivers of productivity
5 improvements.

6 Modern railroading is based on the
7 concept of a scheduled operation which rely on
8 predictable repetitive traffic movements that
9 seek to minimize intermediate handling of cars
10 to the greatest extent possible.

11 The introduction of forced
12 switching into the U.S. system risks taking a
13 predictable, productive operation and making
14 it run unpredictably.

15 Even the simplest switching events
16 add complexity and unpredictability and can
17 undermine efficient operations.

18 NITL witness Mr. Schuchmann
19 glosses over the complexity of forced
20 switching by ignoring the many handling events
21 that are required to interchange traffic
22 between two railroads.

1 An interchange just does not
2 involve a single event. Many individual
3 handlings and switching events are required to
4 effectuate a simple interchange as illustrated
5 in the next two exhibits.

6 Exhibit 2 shows an example of
7 originating and a single car -- single-line
8 car and single-line service. It requires six
9 events. That is, switches or movements to
10 move the empty car from the local yard to the
11 origin and the loaded car, back to the yard to
12 be switched into an outbound train.

13 All of these events today are
14 controlled by one railroad.

15 First, the railroad switches the
16 empty car located in its yard to an eastbound
17 train that serves the origin. Second, the
18 weight-train moves the empty car to the
19 origin.

20 Third, the weight-train spots the
21 empty at the origin. Fourth, once the car is
22 loaded, a westbound train picks up -- picks it

1 up. Fifth, the weight-train moves the loaded
2 car to the yard and sixth, the loaded car is
3 switched into a road train and begins its
4 journey to its destination.

5 Now, consider Exhibit 3, which
6 shows what would happen when the simplest
7 possible version of forced -- of a forced
8 switch is made.

9 As you will see, four additional
10 events are required to originate the car and
11 each of these events would need to be
12 coordinated between two railroads.

13 First, railroad two, which is the
14 line haul carrier, must switch an empty car
15 located at its yard into a weight-train that
16 serves the interchange with railroad one, the
17 incumbent carrier that serves the origin --
18 that serves the origin.

19 Second, the weight-train must move
20 the empty to the interchange with railroad
21 one. At that point, railroad one executes the
22 same six events it would execute in a single

1 line movement, events 3/3.

2 However, when the loaded car
3 arrives in the yards, instead of being
4 switched onto a train headed to a destination,
5 it is instead, switched into a weight-train
6 headed back to railroad two.

7 In step nine, the weight-train
8 brings the loaded car back to the railroad
9 two. Finally in step 10, the loaded car is
10 switched into a train beginning its journey to
11 the destination.

12 However, as I described in my
13 written testimony, most forced switches will
14 occur in complex terminals, where neither the
15 track configuration nor the service plans of
16 railroads involved are necessarily configured
17 to accommodate a new forced switch.

18 Given that the railroad industry
19 has spent the past 30 years simplifying its
20 infrastructure and operations, and removing
21 inefficient routings and interchanges, this
22 situation will occur frequently.

1 An example of such a complex move
2 is shown in Exhibit 4, where 24 events are
3 required to implement a forced switch.

4 The example here starts with the
5 same six events on the incumbent needed to
6 originate the move, however, the example
7 assumes that the forced switch could be made
8 to another railroad, shown in blue, but the
9 switch would involve more complex trackage, as
10 would be typical in many urban areas.

11 To make the forced switch, 18
12 additional switch events would be required.

13 I'd like you to notice two things.
14 Just use your imagination.

15 The first, the additional
16 complexity introduced by the forced switching,
17 in this case quadruples the number of events
18 required, simply to originate the car.

19 Second, 12 of the 18 added events
20 required by force switching occur on the line
21 of the incumbent carrier, which is losing the
22 traffic. The incumbent carrier will be

1 required to do three times the work it would
2 do to originate the single-line car.

3 Each new event introduces the risk
4 of failure. In other words, the risk that the
5 railroad would not be able to meet its service
6 plan.

7 You will hear from railroad
8 witnesses tomorrow, how important on-time
9 service is to its rail customers, and even if
10 the risk of failure for each event is small,
11 the overall risk of failure increases, as more
12 events are added to the movement, as shown in
13 Exhibit 5.

14 Even the simplest force
15 interchange increases the number of required
16 events and reduces the likelihood of a
17 successful service plan.

18 When you consider the thousands of
19 cars that would move daily under forced
20 interchange, and the way that service failures
21 ripple through a complex network, such as a
22 railroad system, even a small decrease in

1 reliability creates a very significant
2 problem, creating system delays and increases
3 supply chain cost to shippers and makes rail
4 service less competitive with truck.

5 The adverse effect of interchange
6 and switching on service reliability has been
7 well-established for many years. During the
8 1970's, the United States Department of
9 Transportation funded the freight car
10 utilization program.

11 Work at MIT funded by that program
12 established, as is shown in Exhibit 5, the
13 probability of successfully executing a
14 service plan declines as the number of
15 interchange and switches -- switch events
16 increases.

17 Mr. Schuchmann and NITL do not
18 deny that additional events will degrade
19 service quality. They simply ask the Board to
20 assume that they won't occur.

21 They do not address for the Board,
22 what would happen if these events do, in fact,

1 occur.

2 My written testimony set out in
3 detail, the factors that allow railroads to
4 improve their productivity and service over
5 the last 30 years. Those factors are
6 summarized in Exhibit 6.

7 Each of those factors would be
8 undermined by the increased number of service
9 failures caused by force switching.

10 First, forced switching leads to
11 less efficient use of yards and increased yard
12 congestion.

13 Second, forced switching would
14 create inefficient line haul movements. Those
15 familiar with the history of the railroad
16 industry will recall that in the 1960's and
17 1970's, when numerous routings were available,
18 shippers often chose inefficient routings to
19 gain a lower rate.

20 Third, forced switching would
21 create additional car movements, and that
22 would inevitably degrade service reliability,

1 impact passenger rail service.

2 Fourth, railroad service planning,
3 which is a complex process under the best of
4 circumstances, would be undermined.

5 Fifth, the forced switching would
6 result in the efficient use of infrastructure,
7 equipment and human capital. Just as stable,
8 predictable traffic flows are essential to
9 optimal service planning, they are also
10 essential to optimized investment in
11 infrastructure, equipment and people.

12 Finally, forced switching would
13 increase risk to workers. A labor management
14 committee convened by the Federal Railroad
15 Administration found that most fatal injuries
16 suffered by railroad workers occurred during
17 switching operations.

18 Mr. Schuchmann suggests that
19 railroads are capable of adjusting their
20 service plans to accommodate variations in
21 traffic levels, and that capability would
22 enable them to avoid the adverse impacts of

1 traffic volatility that comes from increased
2 switching, but his argument is flawed.

3 It is true that railroad traffic
4 volumes can change in response to short-term
5 conditions like weather, as well as long-term
6 changes in the markets. Railroads devote
7 substantial resources to addressing these
8 changes, but despite these efforts, responding
9 to even gradual market changes is challenging.

10 Adding further uncertainty through
11 regulation would only compound these
12 challenges and interfere with the railroads
13 ability to respond to dynamic markets.

14 The sources of service disruption
15 from forced switching would also be spread
16 across the network, making it more difficult
17 to anticipate and address.

18 In Exhibit 7, originally included
19 in my verified statement, I identified 22
20 regions in the United States with more than 45
21 potential forced access locations. Including
22 all of the major east/west rail gateways and

1 most U.S. cities, rail lines in these regions
2 also support Amtrak and the expanding regional
3 commuter rail operations.

4 Maintaining fluidity in these 22
5 regions across the remaining rail network is
6 essential to ensuring the level of railroad
7 performance shippers have come to expect.

8 High density segments of the rail
9 network, such as those running through
10 gateways, as shown in Exhibit 7, can operate
11 well under normal conditions, but they are
12 vulnerable and -- two, and recover slowly from
13 disruption, even as small problems can cause
14 gridlock.

15 As anyone who has ever boarded an
16 airplane can attest, its characteristic in the
17 network industry that problem occurring in one
18 part of the network can quickly spread to
19 other parts of the network.

20 Forced switching would severely
21 affect the railroads ability to invest in
22 infrastructure.

1 I now turn to the impact of forced
2 switching on rail investment in
3 infrastructure.

4 NITL has stated that in terms of
5 gross revenue, the railroads would only lose
6 1.3 billion in gross revenue. However, as
7 NITL and its supporters well know, the
8 viability of an enterprise is measured in net
9 income and the availability of cash flow for
10 investment.

11 The gross revenue loss estimated
12 by the NITL would translate into a substantial
13 loss, in terms of net income that the
14 railroads rely on to make infrastructure
15 investments.

16 Historically, net -- railroad net
17 income has been closely tied to capital
18 expenditures. Thus, while the NITL would have
19 the Board focus only on the loss of 2.4
20 percent of railroad gross revenues, the more
21 relevant frame of reference is that forced
22 switching, even using the NITL's under-stated

1 estimate, would eliminate revenue close to 13
2 percent of the railroad industry's capital
3 budget.

4 Therefore, even the NITL's vastly
5 under-stated estimate would hit the railroads
6 very hard, and that's not the whole story.

7 As discussed by other witnesses,
8 NITL calculations materially under-state the
9 actual effects of forced switching.

10 As shown in Exhibit 8, assuming
11 that just 25 percent of the cars eligible for
12 diversion are actually diverted, using NITL's
13 own revenue impact assumptions and the annual
14 revenue lost to the railroad industry in 2010
15 would be \$7.9 billion.

16 That would be incurred due to
17 forced switching that took in -- with the
18 additional direct cost of \$2.5 billion that
19 would be incurred due to forced switching, the
20 total revenue loss would go to \$10.4 billion
21 per year, an amount that exceeds the entire
22 capital budgets of the railroads.

1 This does not take into account
2 indirect costs which cannot even be calculated
3 in advance or the possibility that the amount
4 of switching would be greater than 25 percent.

5 All of these numbers, both those
6 presented by NITL and the railroads are
7 estimates. The inescapable conclusion
8 however, is that forced switching would have
9 such an adverse effect on railroad net income
10 that it would undermine the railroad's ability
11 to maintain infrastructure, good operating
12 order, to add capacity as it's needed.

13 Such an outcome is not in the
14 public interest, especially considering that
15 the U.S. Department of Transportation has
16 projected that railroads will need to add 46
17 percent more capacity by 2040, just to meet
18 the country's freight transportation needs.

19 There is no need to risk service
20 disruptions and reduce infrastructure
21 spending. The shippers that support the NITL
22 proposal have offered no justification for

1 assuming the potentially severe risk of
2 service disruptions and the adverse impact of
3 reduced revenue to fund rail infrastructure
4 and investment.

5 Some shippers, particularly
6 chemical shippers, would likely to attain
7 lower rates, while other shippers would suffer
8 the consequences of a forced activist regime
9 without any offsetting reductions, and the
10 chemical industry has not shown the Board why
11 it should go out of its way to give chemical
12 shippers a favored treatment.

13 As I have described in my prior
14 statements in this proceeding, rail rates
15 overall for chemical shipments have declined
16 23 percent since the passage of the Staggers
17 Act, a period during which the chemical
18 industry itself raised its own rates by 151
19 percent.

20 In closing, let me emphasize that
21 the railroad network in the United States is
22 a national asset. Under the current

1 regulatory structure, it has become the best
2 in the world. Unlike the nation's highways,
3 waterways, ports and airports, the railroad
4 network is privately financed.

5 Public interest is best served by
6 maintaining it in good condition and expanding
7 to meet growing demand in the future. There
8 is therefore, a strong public interest in
9 ensuring reliable railroad industry that has
10 the financial where-with-all to maintain and
11 grow as a vital component of the U.S.
12 transportation system. Thank you.

13 MR. EAKIN: Good morning. Thank
14 you for the opportunity to make these
15 comments.

16 My name is Kelly Eakin. I am
17 Senior Vice President of Christensen
18 Associates, an economics research and
19 consulting firm, located in Madison,
20 Wisconsin.

21 My colleague Mark Meitzen and I,
22 have submitted a joint verified statement and

1 a joint verified reply statement in this
2 proceeding.

3 My brief comments today emphasize
4 the following two key points. One, the
5 mandatory switching proposal represents market
6 intervention that would create a relatively
7 small set of winners, while imposing costs on
8 a much larger group of non-beneficiaries, and
9 two, arguments by proponents that traffic
10 growth will mitigate impacts on railroads are
11 flawed.

12 Let me turn to the first point,
13 that the proposal would interfere with markets
14 in a way that creates winners and losers.

15 Proponents argue that mandatory
16 switching would introduce competition.
17 Instead, it would constitute a regulatory
18 intervention that could lead to resource mis-
19 allocations, decreases in rail maintain and
20 investment and other inefficiencies
21 inconsistent with competition.

22 That is, mandatory switching would

1 not improve market performance and promote
2 efficiency the way true market based
3 competition does, and would likely harm market
4 performance.

5 This proposed market intervention
6 would have other negative consequences by
7 creating winners and losers among shippers.

8 Proponents and other shipper
9 comment -- and other shipper commenters appear
10 to believe that chemical shippers would be the
11 beneficiaries of the mandatory switching
12 proposals.

13 Coal and agricultural shippers
14 appear at best, luke warm about the proposal,
15 and shippers of other commodities have largely
16 been silent.

17 Even within a generally favored
18 industry, there would be winners and losers.

19 Some shippers will be located near
20 working interchanges and would enjoy lower
21 rates made possible by the proposal, but other
22 shippers will be beyond a reasonable distance

1 from an interchange. Those other shippers
2 would be left at a competitive disadvantage in
3 their own markets, as compared to the winners.

4 Most shippers would also face
5 higher costs. As the other AAR witnesses have
6 demonstrated, mandated switching has the
7 potential to degrade network efficiency and
8 increase system-wide costs.

9 All but a narrow group of favored
10 shippers would bear a share of these costs
11 without receiving any benefit from mandated
12 shipping.

13 Now, onto the second point.
14 Proponents suggest that the impact mandated
15 switching on railroads would be mitigated
16 because of substantial traffic growth. This
17 assertion is nothing more than speculation.

18 It is difficult to envision the
19 source of traffic growth. Any traffic growth
20 potential would be limited to the set of
21 favored shippers who obtain lower rates, as a
22 result of mandatory switching.

1 But where would the favored
2 shippers additional -- where would the favored
3 shippers additional traffic come from?

4 Traffic growth that occurs because
5 the favored shippers gain market share from
6 their non-favored competitors is not net
7 traffic growth to the railroads, nor is it
8 likely that favored shippers will shift
9 traffic from other modes of rail -- from other
10 modes to rail, since the mandatory switching
11 proposal is aimed at traffic for which there
12 are no existing competitive alternatives.

13 Furthermore, there would be
14 expected traffic declines by the non-favored
15 shippers because of service deterioration and
16 possible higher rates, and even if mandatory
17 switching were to lead to some traffic growth,
18 the additional revenues would not offset the
19 lost contribution that railroads would incur,
20 and it is the impact on railroad contribution,
21 not revenue, that is the issue.

22 As we demonstrated in our opening

1 comments, if railroads are already pricing in
2 an economically rational manner, any traffic
3 growth resulting from the proposal cannot
4 improve the railroads bottom line.

5 To conclude, motivation for the
6 proposal is clear. Lower prices for the
7 favored shippers. Also clear as the adverse
8 impacts, system inefficiencies and higher
9 costs born by all. That is, the proposed
10 mandated switching would result in a private
11 interest, re-distribution of value among
12 stakeholders, rather than a public interest
13 improvement in market performance.

14 The guiding principle since the
15 Staggers Act has been deference to market
16 forces, where possible, with a regulatory
17 back-stop to protect those shippers who lack
18 effective competitive alternatives.

19 The Board and the ICC before it
20 follow this guiding principle to largely
21 achieve the vision of the Staggers Act. The
22 rail industry today is financially much

1 healthier than the moribund industry of 1980,
2 and shippers have benefitted.

3 The mandatory switching proposal
4 moves away from this guiding principle.
5 Foremost, the proposal represents interference
6 in, rather than deference to markets.

7 The impact would be primarily the
8 re-distribution of value among stakeholders,
9 rather than the improvement in market
10 performance.

11 This impact would go beyond the
12 railroad industry and could alter the
13 competitive process and product markets that
14 use rail transportation.

15 In summary, the mandatory
16 switching proposal represents market
17 interference rather than deference. The
18 result will be creation of winners and losers
19 by regulation. Thank you.

20 MR. IRELAND: Chairman and Vice
21 Chairman, thank you for the opportunity to
22 speak with you.

1 My name is Bill Ireland. I'm
2 currently an independent consultant with Jexi,
3 Incorporated.

4 I was a railroad executive with
5 Canadian Pacific Railroad for more than 29
6 years, before retiring in January 2013. My
7 last position at CP was Vice President Service
8 Design and Asset Optimization, and through my
9 experience with Canadian railroad operations,
10 I have direct knowledge of Canadian rail
11 inter-lining and switching, as well as U.S.
12 rail operations.

13 So, the purpose of my comments
14 today is to explain why the Canadian
15 experience with inter-switching provides no
16 basis what so ever for predicting how a forced
17 switching regime would affect rail operations
18 and the quality of rail states -- rail service
19 in the United States.

20 To start, the Canadian rail
21 system, its history, its development,
22 structure, markets and shippers is

1 fundamentally different from the U.S. rail
2 system. Inter-switching was adopted in Canada
3 some 100 years ago, to avoid duplication of
4 rail infrastructure.

5 Since traffic patterns in Canada
6 have adapted the inter-switching over a long
7 period of time, Canada's experience with
8 inter-switching today says nothing about the
9 impact of a new mandated switching regime in
10 the United States, which has no history of
11 mandated switching.

12 In addition, Canada's population
13 is one-ninth the size of the U.S. population.
14 Its population density is lower and it has a
15 half-dozen major cities, compared to more than
16 50 large cities in the United States.

17 Distribution patterns are thus,
18 much simpler in Canada, and its rail network
19 has evolved to serve a small thinly
20 distributed population, spread along a largely
21 east/west line, as shown in Exhibit 1.

22 The size and the structure of the

1 Canadian rail network is also the product of
2 a national policy focused on resource
3 development and export. By comparison, the
4 rail system in the United States, the worlds'
5 largest economy, consists of a complex spider-
6 web network of rail lines that connect a wide
7 array of commodity production and distribution
8 hubs, as shown in Exhibit 2.

9 U.S. rail traffic flows are
10 dominated by products moving internally and
11 destined for domestic consumption.

12 U.S. rail route miles are nearly
13 five times Canada's, and the U.S. railroads
14 now carry six times as many carloads.
15 Clearly, the different level of scale and
16 complexity of the two countries have a direct
17 impact on the potential risk of congestion and
18 service deterioration that could result from
19 mandated switching.

20 Unlike Canada's simple linear and
21 parallel network, the complex U.S. rail
22 network could be highly susceptible to service

1 interruptions due to the unpredictable and
2 unstable traffic flows created by new mandated
3 switching regime.

4 The spider-web nature of the U.S.
5 network results in more complicated
6 classification activity in major yards,
7 adding more car handling activities, as a
8 result of forced switching, on top of these
9 already complicated car handling activities
10 and yards, particularly those that are already
11 capacity constrained, would significantly
12 increase the risk of service disruptions.

13 Moreover, Canada's largely
14 parallel rail network has only 67 locations
15 where inter-switching takes place between
16 Canada's two Class I railroads, while there
17 are some 1,500 potential interchange points in
18 the United States.

19 Exhibit 3 shows where forced
20 switching would occur in the United States,
21 with each red circle on the map indicating an
22 area with more than 45 potential forced

1 switching points.

2 As you can see, there are many
3 U.S. urban areas where the total number of
4 potential mandated switching locations is
5 higher than the number of inter-switch points
6 in all of Canada, nor is there a single yard
7 in Canada that comes close to the size or
8 complexity of a major terminal area like
9 Chicago, Saint Louis, Houston or Kansas City.

10 I would also like to address the
11 analysis of Canadian inter-switching data by
12 the NITL's consultants.

13 The NITL's claims regarding the
14 frequency of inter-switching in Canada are
15 highly misleading and provide no support for
16 the estimates to the level of switching that
17 would occur in the United States under a
18 mandated switching.

19 Specifically, as shown in Exhibit
20 4, the NITL uses 2007 Canadian switching data
21 to suggest that while the United States has 22
22 times as many switching locations, and six

1 times as many carloads as Canada, mandated
2 switching in the U.S. would produce half the
3 number of switches that occur in Canada.

4 The results of NITL's analysis are
5 implausible in part, because the NITL's
6 calculations are seriously flawed.

7 For example, included Canadian
8 inter-modal traffic and domestic U.S. traffic
9 of CN and CP U.S. subsidiary railroads in its
10 calculations, even though Canada's inter-
11 switching rules do not apply to any of this
12 traffic.

13 Simply correcting this obvious
14 error would increase the NITL's estimate of
15 switched cars to the United States by a factor
16 of at least 14, as shown in Exhibit 5.

17 In conclusion, I hope these points
18 make it clear that Canada's experience with
19 inter-switching cannot be used to predict the
20 potential impacts of mandated switching on the
21 U.S. rail system. The differences between the
22 two systems are significant enough that using

1 Canada as some kind of model for a U.S.
2 switching regime is entirely unwarranted.
3 Thank you.

4 MR. SIPE: As I said at the
5 outset, I am going to conclude our Panel's
6 presentation by highlighting AAR's position
7 regarding the important issues raised in this
8 proceeding.

9 First, let me remind all of us
10 sitting here this morning, that the broader
11 context of this proceeding is a proposal for
12 a fundamental change in STB economic
13 regulatory policy.

14 NITL proposes a rule that would
15 require rail carriers to permit use of their
16 facilities and services by their competitors.

17 If a proposal of this sort were
18 directed at any of NITL's members, it would
19 elicit howls of protest, and it should.
20 That's not the way markets work, not the way
21 real markets work.

22 Maybe markets that have been, and

1 we heard this four times this morning,
2 "injected with competition", but when I think
3 of an injection, I think of something painful,
4 delivered by a long needle, and that's kind of
5 the way AAR thinks of this artificial
6 competition.

7 In addition to impairing rail
8 operations, the NITL proposal would undermine
9 two cornerstones of rail transportation policy
10 that have been in place since Staggers.

11 The policy to rely on competition
12 that exists naturally in the market place to
13 the maximum extent possible, and the policy to
14 minimize Federal regulatory control over the
15 rail transportation system.

16 In other words, NITL wants to
17 restructure rail transportation markets
18 through a new set of regulatory rules. That
19 is the opposite of what Congress legislated in
20 Staggers and ICCTA, and it's the opposite of
21 what has worked well for nearly 35 years.

22 Regarding the specific objectives

1 of this proceeding, the Board sought
2 information that would enable it to assess the
3 likely impacts of NITL's switching proposal.
4 It sought empirical data on specified topics,
5 so that it would be sufficiently informed to
6 make this assessment.

7 But the empirical evidence
8 submitted by the parties supporting the NITL
9 proposal does not allow the Board to predict
10 with confidence, what would happen if the
11 proposal were adopted.

12 The shipper parties, including
13 NITL itself, failed to model various aspects
14 of the proposal. The empirical evidence is
15 not only incomplete, it diverges widely from
16 party to party, and as you heard DOT say this
17 morning, there are different reasonable
18 assumptions that could be made, which produce
19 such wide ranges of estimates.

20 Apart from the uncertainty
21 regarding the impact in the NITL proposal, the
22 proponents of the proposal have presented no

1 reliable evidence of any public benefits would
2 flow from it. They asserted public benefits
3 specifically, in their testimony this morning,
4 and they have asserted public benefits in
5 their written testimony, but I don't think
6 you'll find anything in the record that
7 constitutes an effort to specify or quantify
8 what kind of public benefits they're talking
9 about.

10 I urge you to read the testimony
11 of AAR witness Mark Fagan, who submitted reply
12 testimony on our behalf.

13 Mr. Fagan presents a framework for
14 assessing public benefits and in particular,
15 assessing the potential benefits of an
16 injection of competition against the costs and
17 opines, based on his experience and his
18 analysis of the NITL proposal that no public
19 benefits have been put forth.

20 In deed, the only benefits that
21 NITL and its supporters anticipate are purely
22 private benefits in the form of rate

1 reductions for a subset of shippers.

2 This is simply an alternative and
3 redundant form of rate regulation, but the
4 governing statute and Board rules already
5 provide well-defined vehicles for addressing
6 unreasonable rates, and the Board continues to
7 refine its standards and fine-tune its
8 procedures to make rate cases more accessible
9 to shippers that believe they are entitled to
10 rate reductions.

11 While there is no evidence of
12 public benefits, AAR's and individual railroad
13 comments show that there is a high likelihood
14 that the NITL proposal would result in reduced
15 capital investment in the railroad industry
16 and serious declines in the service levels
17 that today's carrier -- that today's customers
18 enjoy.

19 It would be poor public policy to
20 incur these risk without clear evidence of
21 public benefits that substantially outweigh
22 the risks, but there is none.

1 Notably, the likely degradation of
2 service would affect shippers across the
3 network, regardless of whether their geography
4 made them possible recipients rate reductions.

5 Some shippers might accept service
6 degradation as the price to pay for rate
7 reductions, but many other shippers would be
8 unequivocal losers.

9 This phenomenon of winners and
10 losers argues strongly against the adoption of
11 a risky change in regulatory policy.

12 Instead of empirical evidence of
13 likely public benefits, which is what the
14 Board would need to see from NITL to move
15 forward toward a rulemaking, NITL builds its
16 case for a fundamental change to the Boards'
17 regulatory regime on decidedly non-empirical
18 propositions.

19 One of those propositions is that
20 inter-switching has worked in Canada. Another
21 is that hardly any mandated switching would
22 actually occur if the NITL proposal were

1 adopted.

2 These propositions are no
3 substitute for empirical evidence of benefits
4 and neither justifies imposing switching in
5 the United States.

6 You've heard Mr. Ireland explain
7 that the U.S. rail network bears almost no
8 resemblance to the Canadian rail network, and
9 therefore, attempted extrapolations from the
10 Canadian experience are meaningless.

11 As for NITL's attempt to justify a
12 regime of mandated switching by claiming that
13 hardly any switching will actually occur, that
14 argument conveniently avoids addressing the
15 very real disruptive effects of forced
16 switching, and if true, would only underscore
17 the point that NITL is not really interested
18 in switching, but only interesting in an
19 alternative method of pursuing lower rates.

20 It would not be rational policy
21 for the Board to adopt a new regulatory regime
22 in the hope that it would not be implemented,

1 knowing that if it were implemented, it could
2 cause major operating problems.

3 NITL contends that the Board has a
4 sufficient basis to move forward to a notice
5 of proposed rulemaking. The record compiled
6 in this proceeding demonstrates nothing of the
7 sort.

8 The record establishes that NITL's
9 switching proposal pertains nothing but risk
10 and uncertainty, risk of serious service
11 degradation, risk of reduced investment and
12 uncertainty as to whether the efficiency gains
13 that have benefitted both shippers and
14 railroads in the post-Staggers area, will be
15 sustained.

16 The Board should dispel the risk
17 and uncertainty by rejecting the NITL proposal
18 and terminating this proceeding.

19 On behalf of AAR, thank you, and I
20 believe General Timmons now has a chance to
21 speak on behalf of the Short-Lines.

22 CHAIRMAN ELLIOTT: Do you want to

1 go together in this fashion, or would you
2 rather wait for us to question the AAR and
3 then -- it's up to you.

4 MR. TIMMONS: I am fine, going
5 forward now.

6 CHAIRMAN ELLIOTT: Okay.

7 MR. TIMMONS: Well, good
8 afternoon, Chairman Elliott, Vice Chairman
9 Begeman. Can you hear me okay with this?

10 CHAIRMAN ELLIOTT: Very well.

11 MR. TIMMONS: My name is Rich
12 Timmons, and I am the President of the
13 American Short Line and Regional Railroad
14 Association, and the Association represents
15 550 Class II and Class III railroads, most of
16 which are small and locally based, and on
17 behalf of those members, I thank the Board for
18 inviting interested parties to testify this
19 afternoon.

20 In summary, the three major
21 concerns of the small railroads are as
22 follows:

1 The ASLRRA continues to oppose the
2 NITL proposal, as being injurious to the
3 National Rail Network, as explained by the
4 Class I participants in this proceeding in
5 significant detail.

6 The NITL proposal is likely to
7 cause substantial issues with the fluidity and
8 efficiency of the rail network, including
9 small railroads.

10 Class I service issues directly
11 impact the services that small railroads can
12 provide to their customers and small railroads
13 have a limited ability to manage their own
14 recovery from network issues.

15 It is the short -- it is the
16 Association's position that the STB should
17 deny the relief NITL seeks in its proposal and
18 retain its current competitive access rules
19 codified in 49 CFR Part 1144.

20 The imposition of the NITL
21 proposal on small railroads would be harmful
22 to them, their customers and the communities

1 they serve, due to the fact that small
2 carriers' traffic is particularly subject to
3 diversion already, and allowing Class I to
4 cherry-pick traffic would greatly exacerbate
5 that, and while the NITL proposal that is the
6 basis for this hearing, provides that small
7 railroads would be exempted from the
8 provisions of any revised competitive
9 switching rules, the proposal is ambiguous on
10 that point, and if its proposal is adopted by
11 the STB, any such rule must specifically
12 exempt small railroads from any new rules on
13 this subject.

14 The Association submits that if
15 any new competitive access rules are adopted
16 by the STB, those rules should specifically
17 and unequivocally exempt small railroads,
18 whether they are part of the routing of the
19 traffic or not.

20 The balance of my testimony will
21 address these points in more detail.

22 The small railroad segment of the

1 National Rail System is largely the product of
2 de-regulatory initiatives started under
3 Staggers. That Act allowed small
4 entrepreneurial companies to purchase or lease
5 light-density lines from the Class I carriers,
6 thus preserving rail operations, rather than
7 having those lines fall victim to abandonment.

8 As of 2012, there are 560 small
9 railroads operating over 40,000 -- over 43,000
10 miles or approximately 38 percent of the
11 nation's rail lines. The traffic base of the
12 small railroads is largely made up of general
13 merchandise traffic, highly susceptible to
14 diversion to other modes, and if the NITL
15 proposal is adopted, to Class I carriers, as
16 well.

17 For small railroads, the average
18 route mile distance is 91 miles and the median
19 route mileage is only 34. Small railroads
20 provide competitive service to more than
21 10,000 rail dependent employers, participate
22 in about 44 percent of all carload movements

1 other than coal and inter-modal and play a
2 critical role in the communities that those
3 carriers serve, particularly to those in rural
4 areas.

5 The shippers served by small
6 railroads employ on average 100 employees and
7 nationwide, more than one-million people are
8 employed at facilities served by small
9 railroads.

10 Short lines employ approximately
11 20,000 employees, of which more than half are
12 represented by unions. These railroads
13 transport shippers' traffic over relatively
14 short distances to interchange with Class I
15 carriers. This part of the rail industry is
16 known to provide service on the first mile and
17 last mile of rail freight movements.

18 Their traffic densities are light
19 and their fixed costs are high, and
20 competition from trucks, inter-modal
21 operations, barges and trans-loading
22 operations is fierce.

1 Moreover, relatively few customers
2 account for the majority of traffic on this
3 small railroad line. It is not unusual for
4 three or four customers to account for two-
5 thirds of a small carriers' rail traffic.
6 Loss of all or a portion of the revenues from
7 those moves would be devastating to small
8 railroads.

9 Permitting a Class I to take the
10 traffic away by virtue of the imposition of
11 the rule proposed by NITL would not only
12 deprive the short lines of its ability to
13 survive, but also harm other shippers on a
14 line, that the Class I divested in the first
15 place, because it was a money-losing
16 proposition.

17 The position of the ASLRRRA in this
18 proceeding is as follows:

19 As stated in ex parte 705 and
20 again, in its reply comments in this
21 proceeding, the Association does not believe
22 that changes in the current regulatory

1 structure would serve any valid or justifiable
2 purpose.

3 While the NITL petition exempts
4 Class II and Class III railroads from the
5 provisions of the proposed rule, the NITL
6 petition is ambiguous.

7 If the STB adopts the proposed
8 rule, it must specifically exempt Class II and
9 Class III railroads, to ensure that the small
10 railroads who have no market power in the
11 first place, are not collaterally damaged
12 under the proposals' terms and under any
13 future imposition of it.

14 For example, if the Board decides
15 to adopt the NITL petition, it should
16 expressly limit the application to situations
17 in which no Class II or Class III railroad
18 participates at any point in the movement of
19 the traffic, whether or not the small railroad
20 appears on the waybill.

21 Absent the addition of the
22 specific exemption described above to this

1 rule, an example of how small railroads would
2 be drawn inadvertently into any mandatory
3 switching rules, involves movements in which
4 the small railroad is not shown on the
5 waybill, but still negotiates its own pricing
6 for the final few miles of transportation to
7 and from the customer.

8 As written, if the small railroads
9 connecting Class I railroad must offer a
10 competing Class I access to a shipper, the
11 connecting carrier may be forced to grant
12 access over the small railroads route.

13 Though unintended by the proposed
14 rule, the small railroad would involuntarily
15 exchange its compensatory short-haul rate for
16 a modest Government imposed access fee that
17 would certainly impact the overall viability
18 of the small railroad.

19 To be clear, there is no access
20 fee which could adequately compensate the
21 small railroad for the loss of customers and
22 corresponding revenue.

1 Another example of an additional
2 adverse effect, the imposition of the proposed
3 rule on small railroads might be when a small
4 railroad is merely providing contractual
5 switching services to a Class I carrier as its
6 first mile/last mile.

7 If the Class I either A) is
8 required to provide another Class I access or
9 B) reduces its switching charge to meet the
10 requirements of a mandated switching rule.

11 As a practical matter, the Class I
12 carrier will pressure the small railroad to
13 re-negotiate its contract to a lower rate,
14 reflecting the regulatory limitation
15 applicable to the Class I carrier.

16 The ASLRRRA submits that the STB
17 should retain the current regulatory structure
18 that has promoted the development of a viable
19 and sustainable national rail network, to
20 change the current regime without a clear
21 understanding of the implications and without
22 a clearly established benefit for all

1 customers would be detrimental to the small
2 railroads by virtue of the potential damage to
3 the rail industry.

4 The NITL proposal could add
5 unnecessary switching activity on the rail
6 network, decrease the efficiency of an already
7 complicated series of operations, with a
8 potential to disrupt traffic patterns, produce
9 congestion in rail yards and drive down
10 switching costs to the short lines, which as
11 explained below, will undermine the long-term
12 viability of the rail service provided by the
13 short line railroads.

14 In addition, the reduced
15 efficiency of any one rail carrier, Class I or
16 otherwise, impacts connecting small railroads
17 to the detriment of customers. With these
18 risks in mind, and without clearly established
19 benefits for all customers, the Association
20 continues to oppose the NITL proposal as being
21 injurious to the National Rail Network.

22 With particularly adverse

1 consequences for the 560 small railroads
2 operating in 49 states, and their customers
3 and the communities they serve, while a Class
4 I carrier could, as a result of re-regulation
5 of switch charges, absorb a reduction in
6 overall revenues that generally compensate the
7 Class I for long-haul moves, it is a far
8 different matter for small railroads.

9 The average length of haul for
10 switching in terminal small railroads, for
11 example, is 14 miles and their median length
12 of haul was only five. Switching operations
13 would represent a disproportionately high
14 amount of small railroad revenues, if the
15 switching -- is switching is defined as
16 movements of less than 30 miles, as proposed
17 in the NITL position.

18 In fact, about 45 percent of the
19 nation's small railroads are less than 30
20 miles in length.

21 Moreover, unlike Class I carriers,
22 small railroads have virtually no bargaining

1 opportunity to enter into reciprocal
2 switching arrangements, since they typically
3 operate at only one or two interchange
4 locations.

5 The ability of small railroads to
6 maximize revenues from their single limited
7 operating territories is critical to their
8 viability.

9 None of the analyses submitted by
10 advocates of the NITL petition identified
11 shipments involving small railroads at the
12 origin or destination that are not shown on a
13 waybill. Thus, the small railroads' role in
14 those movements is likely much greater than
15 realized.

16 In the short -- in the
17 Association's study conducted for EP 705, 40
18 percent or more of the carloads in many
19 commodity classifications were handled by
20 small railroads at either origin or
21 destination.

22 Thus, the advocates of the NITL

1 position -- petition fail to acknowledge both
2 the frequency with which small railroads would
3 be involved in moves subject to the proposed
4 rule, and the dis-proportionateley adverse
5 effect a Government imposed fee would have on
6 small railroad revenues.

7 The NITL assertion that the
8 potential loss of railroad revenue would be
9 small, in the low single digits as a percent
10 of overall carrier revenues for Class I
11 railroads, is certainly inaccurate concerning
12 small railroads. The problem for short lines
13 is that a significant revenue reduction from
14 even one large customer has an outsized
15 impact, since three or four customers
16 typically generate the majority of the small
17 railroads revenues, and while there are
18 positive indicators of continued short line
19 growth, the Board should be aware that the
20 small railroad industry has not returned to
21 the 2006 peak year for carload volume and
22 small railroads earn barely six percent of

1 national freight revenues.

2 The modern small railroad industry
3 sector has been created largely by Class I
4 railroad system rationalization, whereby lines
5 that did not meet return on asset standards
6 were divested to new operators.

7 In the future, the unintended
8 consequence of the downward pressure on short-
9 haul rates through either mandated switch
10 charges or Government set access fees, may
11 minimize the ability of Class I's to continue
12 the process of transferring lines to small
13 railroads when it makes operating or financial
14 sense to do so, not to mention, disrupting the
15 negotiated economics of those already in
16 existence.

17 With the eventual downward
18 pressure on short-haul rates, it is very
19 unlikely that a small railroad would be able
20 to profitably operate labor-intensive
21 switching operations. As a consequence, the
22 short line model that has saved rail

1 infrastructure will cease to exist.

2 Abandonments and fewer service options for
3 shippers will be the end result.

4 Moreover, imposition of the NITL
5 proposal will immediately make it more
6 difficult for small railroads to obtain
7 capital to build and maintain their systems at
8 a reasonable cost, as the market quickly marks
9 down their future cash flow.

10 Another impact not addressed in
11 the NITL proposal is the degree of
12 disincentive future rail shippers or receivers
13 would have to locate on a small railroad.

14 Currently, rail customers are
15 attracted to locations served by small
16 railroads, as a result of superior local
17 service and where available, unbiased access
18 to multiple Class I carriers.

19 Imposition of the NITL proposal
20 would provide a potentially serious
21 artificially induced disincentive against
22 future customers locating on small railroads.

1 Regarding the various fee
2 proposals that have been suggested by the
3 advocates of NITL -- of the NITL proposal,
4 none of them works for small railroads. A
5 single fee schedule imposed upon small
6 railroads would present an insurmountable,
7 economic obstacle for most. It would
8 inevitably be much lower than the revenue
9 generated now and there would no place to find
10 and off-setting increase in revenue or a
11 matching reciprocal arrangement.

12 Some comments suggest that in lieu
13 of a rigid fee schedule, an URCS based limit
14 on revenue over variable costs, such as 180
15 percent, would be a reasonable alternative.

16 In fact, any notion that revenue
17 over variable cost might be appropriate for
18 limiting the price of a movement between a
19 customer facility and an interchange point
20 would be extremely harmful to short lines.

21 First, URCS costs are based on
22 Class I operations and have not relevance to

1 small railroad costs of operating light-
2 density, labor-intensive properties,
3 delivering carload traffic over short
4 distances.

5 Second, the nature of terminal
6 operations equates to high fixed costs. A
7 regulatory limit based on any kind of variable
8 cost analysis would deprive small railroads of
9 any recover of the real cost driver for
10 terminal switching movements.

11 In fact, the pricing model for
12 most small railroads is completely different
13 than for Class I railroads, whose rates are
14 based in part on length of haul. Most small
15 railroads are not.

16 The issue of cost variability is
17 completely different for Class I carriers and
18 small railroads. In the face of limits tied
19 to the revenue to variable cost formula, small
20 railroads would have no option to adjust.

21 Under this scenario, many small
22 railroads would likely shut down if forced to

1 cut their switch charges below current market
2 rates, since there is no corresponding
3 opportunity to cut costs or increase revenues
4 elsewhere. Of necessity, these costs would be
5 passed to other customers.

6 The proposal to adopt inter-
7 switching rules such as those administered by
8 transport Canada is the wrong approach, as
9 those rules are largely inapplicable to the
10 U.S. rail industry as a whole, and are wholly
11 irrelevant to the operations of small
12 railroads in this country.

13 In Canada, there are only two
14 large trans-continental railroads and very few
15 independent short line carriers. The concern
16 of small railroads about the ambiguity of the
17 current NITL proposal is based on a number of
18 factors.

19 Without a specific exemption
20 written into any new rule -- just a moment
21 more, sir?

22 CHAIRMAN ELLIOTT: Please

1 continue.

2 MR. TIMMONS: It will prove hard
3 to keep the new rule from imposed on small
4 railroads because of the inevitable anomalies,
5 the ambiguousness of the language proposed by
6 the NITL rule will create over time.

7 Shippers will begin to shift their
8 business from perceived high-cost switching
9 carriers to locations where cheaper Government
10 mandated access fee prevails to the detriment
11 of short lines.

12 This logical strategy would lessen
13 competition over the longer term and the
14 availability of rail infrastructure that is
15 currently maintained by small railroads for
16 the benefit of those shippers that are not
17 within a reasonable distance of a working
18 interchange.

19 This is a critical issue for
20 shippers, if it's keeping rail transportation
21 up and options available to the light density
22 fringes of the National Rail Network is the

1 very essence of the small railroads role.

2 On the other hand, by imposing the
3 exemption in the rule, the interest of the
4 public, the shippers, the small railroads
5 would be protected from the unintended
6 consequence of NITL's proposed rule. Up to 80
7 percent of small railroad traffic is subject
8 to competition from trucks or barges, and the
9 presence of the small railroad is strong
10 evidence that competition to the interchange
11 already exists, thus limiting the application
12 of the rule to movements where no small
13 railroad participates should not have any
14 adverse implications for shippers.

15 In conclusion, the Short Line
16 Association believes that little good and
17 significant harm would be risked by adopting
18 the NITL proposal, but in any event, we
19 implore the STB to include a clear and
20 unambiguous exemption in any rule, to protect
21 the small railroads from the unintended
22 consequences of any regulatory changes.

1 This will continue to allow the
2 short line industry to function effectively
3 for the benefit of shippers, the small
4 railroads and their employees and community
5 stakeholders.

6 Mr. Chairman, Ms. Vice Chairman, I
7 thank you for your time and your attention.

8 CHAIRMAN ELLIOTT: Thank you for
9 your testimony. A few questions.

10 What I've heard here today are two
11 entirely different stories, one from NITL and
12 one from AAR.

13 With respect to the service issues
14 that you raised, and for good reason, we don't
15 want any service issues of great magnitude
16 that destroy the system, NITL raised in their
17 argument or their testimony, about significant
18 changes in the amount of traffic year over
19 year that occurs, and also noted that there
20 are numerous examples of reciprocal switching
21 situations across the country now, I assume
22 including the shared assets area.

1 How do the railroads, those
2 statements against what you've just said?

3 I mean, is there a reason why this
4 would create more problems than the problems
5 or the situations that already exist, with
6 respect to the changes in traffic and the
7 existing reciprocal switching situations?

8 MR. RENNICKE: If I could just
9 make a couple of comments on that?

10 CHAIRMAN ELLIOTT: Sure.

11 MR. RENNICKE: One of the -- I
12 think the issues get -- to address that gets
13 back at what has been the evolution of the
14 infrastructure that supports the railroads as
15 they sit today.

16 If you go back to this freight car
17 utilization program, which I participated in,
18 back in the 1970's, it was clear that the
19 connection points between railroads, both
20 commercial and physical, were so large that it
21 became almost impossible to optimize or offer
22 good services.

1 So, several things happened, you
2 know, including the creation of Conrail, which
3 combined a whole bunch of entities in to one.

4 There were -- the regulations
5 allowed certain route closings or regulatory
6 things on the commercial side.

7 The result of that has been the
8 change in the network, so that for example,
9 there is over 10,000 miles of yard tracks that
10 have been removed in the last 20 years.
11 Hundreds of interchanges have been closed.

12 Yards that exist today, that would
13 be subject to this provision, may only handle
14 10 cars, but the potential for reciprocal
15 switching or for forced switching may be
16 adding 50 or 60 cars from a yard next door.

17 So, you're taking in essence, a
18 network, an infrastructure, a machine, if you
19 think of it, that's been designed and
20 configured to handle certain types of traffic
21 flows, and certainly, they go up and down, but
22 they're going up and down within the confines

1 of an infrastructure network that's been
2 crafted and existed to meet it, and now,
3 you're saying that there can be all kinds of
4 new artificial changes to it.

5 I think that's probably where one
6 of the most fundamental changes is going to
7 be. The infrastructure just isn't there any
8 longer to support this wide-ranging reopening
9 of -- or creation of switch points.

10 MR. SIPE: If I may elaborate.
11 Another point that is in Mr. Rennicke's
12 testimony, and I think he alluded to it this
13 morning, is that switching necessarily
14 introduces a need for communication between
15 two railroads, and the experience of
16 operational planning is that it goes
17 considerably more smoothly when it's under the
18 auspices of a single planning entity, and
19 doesn't require communications back and forth,
20 particularly if things happen in the switching
21 world where you don't have an operating plan
22 that calls for somebody to arrive on your

1 doorstep with a car and say, "Hey, here it is.
2 We want it to be switched."

3 MR. RENNICKE: One other point,
4 and one of the real breakthroughs that came
5 out of the work that was funded by the DOT in
6 the 70's and 80's was that the more events you
7 create, if you think of your airline
8 experience.

9 If you have a choice of going
10 point-to-point on an airline trip, your
11 probability of making it there is much greater
12 than if you decide to take a route that's
13 going to go through three different hubs, and
14 why? Because it's just a physical principle.

15 The more situations there are, the
16 more events, the more times that things could
17 happen, something happens, there is a certain
18 probability, and that -- and the railroad
19 industry and part of this technology that was
20 mentioned that our firm has, for example, is
21 focused on driving down the numbers of those
22 events, so that you can have a whole bunch of

1 non-stop trips, or as close to non-stop trips
2 as you want.

3 When you introduce this kind of
4 switching, you're now suddenly opening up, to
5 use the airline example, the kind of -- the
6 five-hub or the five airplane change trip,
7 just to get from Washington to Los Angeles,
8 for example.

9 So, that's just the -- it was the
10 physical nature of the way networks work with
11 any kind of network, that the more things you
12 do, the more possibility there is for error.

13 So, the introduce -- introduction
14 of these situations is going to create, as
15 we've tried to show, a much higher probability
16 of failure. Exactly what we don't know is
17 that, but it's going to be much larger than it
18 is now.

19 CHAIRMAN ELLIOTT: And that leads
20 me to my next question.

21 Earlier, when NITL was testifying,
22 I posed a possible safe harbor. In this

1 instance, if you were one point below 240 and
2 that would automatically take you out of that
3 -- NITL's proposal, as a safe harbor.

4 So, if you were up in the 280's or
5 290's, and NITL or a shipper came to you and
6 said, "We'd like access here," if you fit
7 within all the other parameters, what if you
8 had the option of saying, "Okay, instead of
9 doing that, we'll drop it to 239, your rate?"

10 Would that eliminate, and as a
11 result, then they would not have the
12 opportunity to engage in any type of access
13 claim, would that type of safe harbor solve
14 these service issues that you've been raising
15 here today?

16 MR. SIPE: Well, if railroads
17 behaved in such a manner, as to voluntarily
18 take their wallets out and give up a chunk of
19 their revenue, in order to avoid service
20 problems, I suppose that could be a result,
21 but you know, why would anybody say that made
22 this proposal acceptable?

1 They are pressing for a specific
2 form of regulatory change, which would allow
3 access to a second carrier, where it doesn't
4 currently exist.

5 In order for that to be a
6 meaningful threat, it would have to happen in
7 a significant number of circumstances, and I
8 don't think you can solve what is a
9 fundamental problem with a regime that is not
10 pro-competitive, by saying, "We're going to
11 ease the pain by letting you buy your way out
12 of this problem, Mr. Incumbent Railroad," by
13 paying a smaller price than if it went all the
14 way down to marginal cost.

15 CHAIRMAN ELLIOTT: So, if I'm
16 hearing you correctly, I'm not sure if I did,
17 that in essence, it would solve the service
18 issue problem, but it's not something that is
19 exactly what the railroads would like to do,
20 because like we referred to earlier, write a
21 one-billion check or whatever the check would
22 be.

1 MR. SIPE: You certainly heard the
2 second part of that right.

3 I don't know -- I don't know how
4 railroads would respond to that. I mean,
5 maybe some of them would avail themselves of
6 the safe harbor in some instances, but not
7 others. Maybe they wouldn't.

8 But it's -- it's not something
9 that has the contours in my mind, of a real
10 viable compromise, because it's basically
11 simply saying that we're going to minimize the
12 hit on you, or limit the hit.

13 CHAIRMAN ELLIOTT: Okay, second
14 question, I guess this is more to Mr.
15 Baranowski.

16 When I was looking at the
17 differences in the estimates of the effect,
18 they were clearly significant, and you can
19 correct me if I'm wrong, that the other groups
20 that made these estimates that were
21 significantly lower did not include the 75
22 percent traffic number. Is that accurate?

1 MR. BARANOWSKI: They didn't,
2 that's accurate.

3 CHAIRMAN ELLIOTT: Yes?

4 MR. BARANOWSKI: They didn't
5 include that as -- or they filtered out --

6 CHAIRMAN ELLIOTT: Right.

7 MR. BARANOWSKI: -- without
8 recognizing or acknowledging the 75 percent
9 portion of the proposal.

10 CHAIRMAN ELLIOTT: And then with
11 respect to your numbers, if you did take that
12 portion out, what would that do to your
13 numbers, as far as the effect?

14 So, let's say you were based on
15 the assumption that the Board said no to the
16 75 percent, and we just went with the 240.
17 What would that do to your numbers, as far as
18 how the proposal would affect you?

19 MR. BARANOWSKI: It's not
20 something I've calculated, but it would reduce
21 the numbers by a number of million carloads.
22 I don't know how many.

1 You can get some idea by looking
2 at my Figure 2 and just looking at the
3 differential between the two -- the first top
4 two red bars, and you can see that I started
5 with the 7.5 million.

6 There is a reduction that occurs
7 in the NITL filters to exclude the KCS, CP and
8 CN, and that's the big chunk of what gets you
9 from 7.5 down to five. Some of those would --
10 some of those are above 240. Some of those
11 would be subject to the 75 percent rule.

12 But then the next filter is, okay,
13 from the five-million, what happens if you
14 limit the filter-only on 240 percent, and
15 that's the difference between the five-million
16 and the 1.6.

17 CHAIRMAN ELLIOTT: Okay.

18 MR. BARANOWSKI: So, it's 3.4
19 million.

20 CHAIRMAN ELLIOTT: Got it, thank
21 you. Vice Chairman?

22 VICE CHAIRMAN BEGEMAN: Thank you.

1 Mr. Rennicke, if I could start with you.

2 One of the charts that I thought
3 was quite interesting, although I'm not sure
4 if I understood it fully, dealt with the six
5 steps that happens in, just one generic
6 switch.

7 It was six steps and then it
8 became 12 and then somehow, it became 21 or
9 24, and I'm trying to understand, is it that
10 six steps happen in just one carrier switch
11 all the time, correct?

12 MR. RENNICKE: What we tried to do
13 is -- was to be as conservative as possible,
14 is to demonstrate that in the simplest form,
15 a simple interchange -- a simple activity of
16 originating a car would take six steps.

17 The car has to arrive in the yard.
18 The empty gets spotted. The car is loaded.
19 It's pulled.

20 Then the next --

21 VICE CHAIRMAN BEGEMAN: Day-to-day
22 business, that's the way it works?

1 MR. RENNICKE: Day-to-day
2 business. The next situation said, all right,
3 let's take the absolute simplest forced switch
4 that we could think of, and that was where we
5 added the other four, because now, the empty
6 car does not come on the serving railroad. It
7 comes on the new railroad.

8 So, the empty car -- so, there is
9 four extra events to get the car from the new
10 railroad onto the existing -- the incumbent
11 railroad, so that it can be spotted.

12 Where the 24 comes in is that
13 there is very few places in the North American
14 network that I've seen, that really look like
15 that pure case.

16 There is basically -- in many
17 cases, the 30 miles -- the lines may be close
18 by 30 miles, even if it's directly connected
19 by rail, but the two points aren't continuous.

20 So, you've got to go down to a
21 junction and then come back.

22 What we tried to do was think of a

1 reasonable surrogate for those complicated
2 situations and said that in those cases,
3 because you're passing an empty car from
4 railroad one to railroad two, there were going
5 to be, in a large number, 24, there could even
6 be 30 or 40 different events that have to take
7 place, as the car tumbles through the system.

8 I think tomorrow you'll see from
9 the railroad, some actual graphics and
10 pictures of what that will look like.

11 But I don't think that that
12 situation is that uncommon. If you look at
13 big terminal areas like Chicago, Saint Louis,
14 Kansas City, the ability to be passing cars
15 back and forth in that kind of complex network
16 is going to -- it's going to require multiple
17 events, far more than the simply throughput
18 that the current carrier has.

19 If I could, those have -- those
20 events then, going back to just the research
21 that was done in the 70's and 80's, every one
22 of those, because there is a potential risk,

1 and we took a very small -- a very
2 conservative view that it was only a two
3 percent risk of failure.

4 I mean, in most cases, it's like
5 three or four percent, that every time you
6 expose yourself to an event, and it's not just
7 with railroads, with anything you're doing,
8 you expose yourself to an existence of
9 failure.

10 So, the railroads have worked to
11 squeeze out as many of those events as
12 possible, to make their system as simple as
13 point-to-point as they can, and that's how
14 service reliability has come up. I mean, it's
15 one of the main reasons why railroads work a
16 lot better in 2014 than they did in 1978.

17 You know, they've vastly
18 simplified how the system works, and this
19 process introduces a whole bunch of new
20 events, of things that have to happen, that
21 have the possibility of a failure at each one
22 of those points. The locomotive is not there

1 in time, the track is blocked, there is a
 2 mechanical failure of some kind, all of those
 3 things that happen every day in railroading,
 4 which -- bad weather.

5 But the more exposure you have to
 6 events, the more -- the higher the probability
 7 of failure.

8 VICE CHAIRMAN BEGEMAN: And I am
 9 not discounting the events and the risks that
 10 you're talking about, but it is true that the
 11 railroads are doing this all the time. I
 12 mean, that's their business; they're switching
 13 traffic. They're --

14 MR. RENNICKE: Right, they are
 15 doing it all the time, but they've
 16 conscientiously, I mean, my experience, for
 17 the last --

18 VICE CHAIRMAN BEGEMAN: They're
 19 doing it the way they want to do it.

20 MR. RENNICKE: They've
 21 conscientiously tried to engineer-out that
 22 kind of multitude of events over the last 30

1 or -- or since Staggers, since the 1980's.

2 There has been -- if you look at
3 the planning, and there will be some -- some,
4 I think will testify here tomorrow. The
5 planning departments of railroads have tried
6 to engineer a network that supports a high
7 degree of customer service, by engineering-out
8 a lot.

9 So, does -- is there switching
10 that does occur? Yes. Is it -- interchanges
11 do occur, but there is less and less of that
12 today and every day, than there has been in
13 the past, and that gives you a network that
14 allows, as we pointed out, you know, traffic
15 goes up, traffic goes down.

16 But it's going through a network
17 that has been streamlined to be very
18 efficient, and it's not just the carload
19 network.

20 If you go back to the 1980's,
21 there were 400 or 500 inter-modal terminals in
22 the country. You'd have little -- they call

1 them circus ramps, out in the middle of the
2 corn fields in Iowa, where you could take a
3 trailer off.

4 The railroads found that they
5 couldn't do business that way. They had to
6 pick 15 or 20 major hubs for inter-modal to --
7 where they would originate or terminate
8 traffic and suddenly, the service took off
9 because they would use the trucking industry
10 to do the last mile.

11 So, it's network simplification
12 that has led to better reliability. To me,
13 this proposal goes in the opposite direction.
14 It starts reopening a whole bunch of areas
15 where complex activities have to occur that
16 would lead to more failure.

17 VICE CHAIRMAN BEGEMAN: Well, I
18 guess if you could contrast that with what
19 happens when there is a railroad merger, it
20 hasn't happened in my time here.

21 But the Board of ICC have --
22 before they've agreed to mergers, imposed

1 various conditions, including some type of
2 competition, terminal access, switching,
3 etcetera.

4 The railroads happily take that
5 decision and start conducting business.
6 Sometimes, not without pains, in implementing
7 it, but they figure it out.

8 MR. SIPE: As I understand your
9 question, Vice Chairman, there are two
10 dimensions to it, and one of them, the first
11 one, very much reinforces what Mr. Rennicke
12 was just saying, which is, the network
13 rationalization dimension of rail mergers.

14 Everyone that I've been involved
15 in, and I was involved in most of the big ones
16 of the 90's up through Conrail, there is a
17 huge focus on single-line carriers and
18 reducing the number of carriers in the route.

19 That's consistent with all of
20 these other network rationalizations that Mr.
21 Rennicke has been describing, which have
22 contributed to evolution of the modern

1 railroad.

2 Another dimension of your
3 question, I think I was hearing was, the
4 conditions to basically, maintain competitive
5 options, which in certain transactions, were
6 -- the conditions were quite widespread, and
7 UP-SP is a good example of where there were
8 widespread imposition of conditions, which did
9 involve two carriers working together, so that
10 a second carrier would have access to shippers
11 over the lines of one of the merging carriers,
12 in order to avoid a reduction in competition.

13 Yes, the carriers have learned to
14 live with an accommodate those matters. I
15 will point out, however though, that the big
16 beneficiary of the access in the UP-SP merger
17 was BNSF, and my understanding, although I
18 have not personally been involved in those
19 matters, is that there has been a fairly
20 significant docket of issues involving the
21 implementation of those conditions over time.

22 I mean, it's not easy. They do

1 it, and it has worked to preserve competition,
2 but it's been challenging.

3 MR. RENNICKE: I think if you go
4 back to the -- and it's been a long time since
5 there has been a big complex merger, but there
6 were big sections of that process, where you
7 had to disclose and lay out the operating
8 plan, and our operation up there in Princeton
9 that has the models to do that.

10 Part of the decision that allowed
11 the merger was the -- STB and the regulators
12 getting confident that in fact, there was a
13 true benefit, in terms of cost reduction,
14 efficiency, better service.

15 If you got into the details of
16 what's behind those plans, they're basically
17 streamlining the system. They're closing
18 yards. They're closing interchanges. They're
19 building volumes of traffic that one railroad
20 didn't have, but now, two of them do, so they
21 can through blocks of -- or entire units --
22 trains of traffic from Point A to Point B

1 without switching.

2 So, as you look back, for example,
3 on the UP-SP merger, whole yard were closed in
4 downtown -- in Los Angeles, in California,
5 because you didn't need them anymore, because
6 the efficiency you got out of combining the
7 two, and that's what -- that's all been part
8 of a multi-step, every year, make it run
9 better program that the railroads have done to
10 try to cut out the duplicative events and
11 unefficient events -- inefficient events.

12 VICE CHAIRMAN BEGEMAN: Well, if I
13 can ask then, sir, with that back-drop, what
14 level of competitive switching could the
15 industry manage?

16 I realize, you know, you've
17 certainly done a good job at saying that the
18 previous Panels' estimate -- like, no one
19 really knows. There is still -- we don't know
20 the scope, etcetera, etcetera.

21 Is there any level of competitive
22 switching that would be acceptable from your

1 --

2 MR. SIPE: I don't know the answer
3 to that. We haven't looked at that, and I
4 would be guessing and speculating, which I
5 don't think would be helpful to the Board.

6 You will, as Mr. Rennicke
7 indicated, you will have specific railroad
8 witnesses testifying tomorrow, and several of
9 them are going to be addressing service
10 issues, and I think you'll have an opportunity
11 to talk to people who are considerably more
12 knowledgeable about operations than I am.

13 VICE CHAIRMAN BEGEMAN: Mr.
14 Ireland, could we talk about your experience
15 or insight from the Canadian rail side-- and
16 I understand the message, do not use the
17 Canadian model here.

18 But as I asked the other Panel,
19 try to walk through how it works.

20 How it does work in Canada? Does
21 a shipper actually call up, or is it already
22 worked out and it's standard operating

1 procedure and it's just on automatic pilot at
2 this point?

3 MR. IRELAND: Yes, there are
4 certain inter-switch locations and again, you
5 know, similar to what's being proposed, you
6 know, that it's a radius within -- you know,
7 if a customer is located within a radius of
8 the two railroads, then they can access
9 another one.

10 I would say the maximum there is
11 30 kilometers, which is actually only 18.6
12 miles. So, it's smaller than what's being
13 proposed.

14 I would say, you know, similar to
15 what you've heard here before, you know, the
16 inter-switch locations tended to be the places
17 that gave us the most problems, because you
18 don't have the visibility into the traffic
19 flows, and then you can't plan and resource
20 for it, the way you can, you know, for the
21 volumes that you had to deal with on your own
22 network.

1 So, you know, you're relying on a
2 communication process between two different
3 companies, and that always doesn't work as
4 well, and they're both managing their networks
5 for various issues, and so, it doesn't always
6 coordinate as nicely as you would like, if you
7 had it all under your control.

8 So, my experience was inter-switch
9 locations tended to give us the most problems
10 around planning, resourcing and executing, and
11 there was knock-on impacts to other customers,
12 as well too, because when it goes bad at a
13 certain location, it's not just the inter-
14 switch traffic that's impacted. It's all the
15 other traffic that's, you know, touching or
16 involved in that area, that can be negatively
17 impacted.

18 MR. IRELAND: And then I guess the
19 final thing I would just add again is that,
20 you know, again, it's a very simple network in
21 Canada, basically two parallel lines.

22 So, you know, I'm telling you,

1 we've had problems. It's just not as complex
2 as what you've got in the U.S.

3 Again, only 67 locations
4 potentially in Canada, where inter-switching
5 could occur, versus you know, 1,500 in the
6 U.S.

7 VICE CHAIRMAN BEGEMAN: But is it
8 being used? Is it actually being executed or
9 is it a back-stop for negotiating rates?

10 MR. IRELAND: It is being used in
11 some locations.

12 You know, I'm not on the
13 commercial side of the business, so, you know,
14 but I'm sure it's being used to discuss rates,
15 as well, too.

16 VICE CHAIRMAN BEGEMAN: I guess
17 I'll just have one last question, and that
18 will be for Mr. Eakin.

19 One of the things that --
20 hopefully I'll have your quote right, but you
21 basically said, this is picking winners and
22 losers, and that losers are going to be left

1 at a competitive disadvantage. Isn't that
2 where they already are?

3 MR. EAKIN: No, that was within a
4 generally favored industry, those within the
5 radius would get lower rates. Those outside
6 the radius will not get lower rates. That
7 changes the competitive framework within that
8 industry, and so, that's how those -- the non-
9 beneficiaries within the generally favored
10 groups become losers within their industry,
11 because they stay the same and the others get
12 a rate cut.

13 So, the others have a lower cost
14 and they're in a competitive -- the non-
15 beneficiaries are at a competitive
16 disadvantage.

17 VICE CHAIRMAN BEGEMAN: So,
18 they're treated the same as they were or
19 they're actually being treated worse, the
20 rates will go up or what?

21 MR. EAKIN: It's a relative
22 statement. They're the -- their costs are

1 staying the same. Their competitors costs are
2 going down.

3 VICE CHAIRMAN BEGEMAN: So,
4 they're not affected?

5 MR. EAKIN: No, they are affected,
6 because they now have to -- they are now at a
7 competitive disadvantage. They may go out of
8 business because they have higher costs than
9 their competitors.

10 VICE CHAIRMAN BEGEMAN: That's it.

11 CHAIRMAN ELLIOTT: Quick follow up
12 with Mr. Baranowski.

13 So, I made the assumption that we
14 were going to take out the 75 percent, and you
15 showed me, as best you could, the effect that
16 that would have.

17 What also would happen if we,
18 instead of the 240, used the RSAM number as
19 the cut-off point? What different effect
20 would that have?

21 MR. BARANOWSKI: It would change
22 the numbers. Again, it's not something that

1 I calculated.

2 The RSAM's are moving around a
3 little bit and they're different for each
4 carrier, and I apologize for not remembering
5 exactly where they are.

6 To the extent that they're higher
7 than 240, the number of relative shipments
8 would be reduced. To the extent that they're
9 lower, it would work the other way.

10 CHAIRMAN ELLIOTT: One further
11 question, and I'm not sure if this will make
12 sense.

13 But I was earlier, raising a
14 possibility of safe harbor, which would hit at
15 240.

16 So, I would assume if the
17 railroads -- I know Mr. Sipe may disagree,
18 that if they dropped their number to, instead
19 of something above 240, to 239, to get out of
20 having to participate in one of these
21 reciprocal switching situations.

22 So, if in all of these situations,

1 the railroads dropped their rate to 239, as
2 opposed to letting competition take place,
3 which I assume was built into your numbers, do
4 you know what effect that would have if we
5 just stayed right around that 240 number?

6 MR. BARANOWSKI: I don't, and
7 there are too many ambiguities in the proposal
8 for me to have looked at any potential revenue
9 impacts, including what would happen if you
10 changed R/VC ratios.

11 CHAIRMAN ELLIOTT: Okay, and then
12 I have two more questions, more general, and
13 I'll let Mr. Baranowski off the hook.

14 The Vice Chairman asked earlier,
15 with respect to -- I guess it relates to the
16 discussion of winners and losers, and she
17 raised the question with the NITL panel, that
18 what would happen if this was implemented?

19 Would the pricing flow more to
20 shippers that are captive or subject to market
21 dominance, and as a result, they would end up
22 paying more than they're paying now, and that

1 the shippers that had been captive in the
2 past, would get lower rates?

3 Would the money just flow
4 elsewhere?

5 MR. EAKIN: This is, in an
6 accounting sense, what I call pushing on the
7 balloon, that it's got to come from somewhere.

8 The rates are going to be going
9 down to the favored shippers. So, it will
10 either come -- it will come somewhere, but and
11 no value is being created, and also possibly,
12 some inefficiencies are being introduced. So,
13 there might be more burden to collect.

14 So, there is a shift that goes on,
15 as the favored shippers now have lower rates.
16 That's going to be made up from some -- from
17 the other stakeholders, from the other subset,
18 and that's either the railroads or the other
19 shippers, which can either be shippers with
20 only one railroad or shippers elsewhere.

21 But somehow, it's got to be
22 accounted for there.

1 Now, if the railroads are pricing
2 to extract every nickel in every market, well,
3 then it can't come from those other markets,
4 but if there is some slack in there, it can
5 come from those other markets.

6 So, you know, just in an
7 accounting sense, it's got to come from
8 somewhere, and it will either come from the
9 railroads, which will then reduce their
10 revenues, or it will come from other shippers
11 in the form of higher rates.

12 MR. RENNICKE: One thing maybe
13 from a practical sense, if you look at
14 maintenance away and spending and CAP-X and
15 locomotives, there is a very high correlation
16 between operating income and that amount.

17 If you look at the physical
18 condition of the railroad, there is a -- you
19 know, as time marches on, things happen, ties
20 have a 30 year life. Rail wears out, so much
21 as 10 miles. So, they have to put so much
22 money into it.

1 So, you would think that if you're
2 going to solve or continue to put money into
3 the system, to build it out to the 240
4 predictions that the DOT says, you're going to
5 have to get money from somewhere.

6 So, any loss from one place, if in
7 fact, you want to keep the infrastructure and
8 equipment up to the level, you're going to
9 have to look for it somewhere else, unless you
10 get, you know, get into some kind of
11 Government subsidy, which I don't think is
12 going to happen, because you can hardly
13 subsidize -- the Government hardly covers all
14 the other modes.

15 I mean, there is not enough money
16 for barges, for airports, all these other
17 things.

18 So, that is the kind of reality
19 check, I think, that the industry looks at,
20 and investors in the industry look at is, how
21 much money has to go into the infrastructure
22 and the rolling stock, to keep up the

1 movement, and if you cut in one place, you're
2 going to have to find it somewhere else,
3 because time will march on and you'll wear
4 out, and you'll have to put money into it.

5 MR. SIPE: Just one final comment
6 on that scenario, and a comment on Dr.
7 Eakin's, "It's got to come from somewhere,"
8 and putting that in an accounting framework.

9 I think I understood what he was
10 saying, is that it may, coming from somewhere,
11 may simply mean that a certain amount of
12 wealth would be transferred from the rail
13 industry to favored shippers, if railroads did
14 not have an opportunity to make that up by
15 charging higher rates, and I think we probably
16 all believe that for the most part, railroads
17 are trying to charge profit-maximizing rates,
18 and that unless there were some changes in
19 demand, which seems to me, to be unlikely to
20 result from -- for the non-favored shippers in
21 particular, changes in demand are not going to
22 result from this proposal. Unless there are,

1 you're not going to be able to get those rates
2 up.

3 So, what that means is you are
4 going to have less revenue available to spend
5 on maintaining infrastructure, let alone
6 expanding it, and I believe this Agency
7 concluded, back in the 1990's, when we had a
8 previous go-round on competition and access in
9 the rail industry, that the most likely
10 consequence of a material revenue reduction
11 for the rail industry, would be a contraction
12 of the industry.

13 Railroads would be able to afford
14 less capacity. That is how the accounting
15 would balance out, over the long-run.

16 CHAIRMAN ELLIOTT: One final
17 question. If in the situation where -- and I
18 know this really hasn't been determined by the
19 Board, but where it's determined that the
20 railroads or a railroad is revenue-adequate,
21 would this proposal be the type of situation
22 or type of method that would be useful in

1 dealing with a revenue-adequate railroad,
2 meaning that they're meeting their cost to
3 capital?

4 MR. SIPE: I don't think so. I
5 don't think the rail industry would agree with
6 that.

7 There are potentially a host of
8 issues associated with revenue adequacy,
9 including determining what constitutes long-
10 term revenue adequacy, before you even get to
11 a question of, do we do something to trim
12 revenues back?

13 But I think it would be a mistake
14 to link those two, the issue of switching to
15 the issue of revenue-adequacy. Different
16 statutory provisions involved. The economics
17 gets really complicated, really fast.

18 VICE CHAIRMAN BEGEMAN: Just one
19 last question. Thank you, General Timmons,
20 for your message. I think we understood it.
21 Perhaps, you'd have the other Panels agree.
22 We'd have one yes' out of this whole

1 conversation.

2 Are there any short line railroads
3 in the world that deal with competitive access
4 requirements?

5 MR. TIMMONS: I don't think so.
6 If I can frame the short line business up, if
7 you'll think of Mr. Rennicke's chart, where
8 the increasing numbers suggested the
9 complexity of what was taking place, if you
10 had this mandatory reciprocal switch.

11 If you plug the short line into
12 that, which is actually serving the customer,
13 you just increase the complexity of that
14 diagram pretty dramatically, because the Class
15 I is now moving his cars, not directly,
16 ultimately to the destination. He is now
17 interchanging with the small railroad. He's
18 moving it up into the destination, picking up
19 the empty, etcetera.

20 So, the small railroad, and
21 they're -- keep in mind, you've got 560 of
22 these guys that are engaged across North

1 America every single day.

2 So, not all of them are going to
3 be involved in this competitive reciprocal
4 switch business. But a number of them will.

5 You asked a question earlier, is
6 any level of reciprocal switching acceptable,
7 and for the short lines, the answer is clearly
8 not, no level.

9 If you look at the very, very high
10 fixed costs for all of these small railroads,
11 and the relatively low variable costs, and the
12 small operating territories within which they
13 operate, they have very little flexibility to
14 make up losses anywhere.

15 So, if you've got an average of 25
16 customers on a small railroad, and the top
17 three or four are generating about 65 percent
18 of the revenue, those are the guys that the
19 Class I guys will focus on, if the small
20 railroads aren't protected, because those are
21 good opportunities to cherry-pick these guys
22 off.

1 Well, if you do that, the impact
2 on that small railroad is pretty dramatic. He
3 can't make up that top customer, that second
4 or third or fourth customer that he's got,
5 that is so very important to his revenues.

6 He's got another 20 maybe, that
7 are generating revenues, but the real money
8 makers are at the top of the pile.

9 So, what you end up with at the
10 bottom, at the bottom of the thought chain
11 here is very, very thin margins, and so,
12 anything that gets in the way of -- or that
13 impacts those margins, whether that's
14 reciprocal switch or bottleneck or anything
15 else, or any other thing that happens to
16 reduce those revenues, has a pretty dramatic
17 impact on those small railroads.

18 So, they are very nervous about
19 this and watch this with great intensity, and
20 so, the shippers and others that might be
21 affected as a result of this, not only will
22 the small railroad that has to endure the

1 reciprocal switch arrangement, but others that
2 are on that line, may also be affected by it,
3 is a very, very serious step.

4 So, I think from a variety of
5 perspectives, whether it's in increased
6 congestion that you experience, or whether
7 it's a variety of shippers that are very, very
8 difficult to predict, that will be impacted on
9 it -- on that requirement, are significant.

10 The extent of congestion and
11 uncertainty and problems associated with this
12 thought, I think is unknowable to some degree,
13 but to be sure, it's significant and serious.

14 MR. RENNICKE: The World Bank, you
15 know, does overviews of the world's railroads,
16 and in there, you'll find analysis that may
17 not be right up there every year, about what
18 goes on in most of the rest of the railroad
19 world, but just where there's open access, or
20 you know, virtual open reciprocal switching.

21 If you look at the -- and you can
22 look at it and draw your own conclusions, but

1 basically, they think a good day is if they
2 can get 50 percent of out-of-pocket costs, of
3 variable costs, out of the rail rates, they
4 think they're in a good position, and the
5 Government is underwriting the infrastructure.

6 So, it's all there. It's -- you
7 know, they do it every three or four years,
8 but I think to answer your question, there is
9 very few situations anywhere in the world, and
10 we've done things like privatized all the
11 railroads and they've been privatized in South
12 America and Mexico and Australia, very few
13 places can the fair-box cover even out-of-
14 pocket costs, where you have open access.
15 It's just, that's where the -- ultimately,
16 that's where the rates wind up.

17 CHAIRMAN ELLIOTT: Thank you. I
18 want to thank the Panel for their testimony,
19 and I think we're up with our final Panel for
20 the day, Panel IV.

21 Okay, why don't we get started
22 with our final Panel, Panel IV, and I believe

1 starting us off is Arkansas Electric
2 Cooperative Corporation, and you have 20
3 minutes.

4 MR. VON SALZEN: Thank you, and I
5 think I'm on.

6 Good morning, or good afternoon,
7 Chairman Elliott, Vice Chairman Begeman. I'm
8 Eric Von Salzen, an attorney for Arkansas
9 Electric Cooperative Corporation, and with me
10 is Michael A. Nelson, AECC's Transportation
11 Consultant.

12 I will outline some of the legal
13 principles that AECC believes the Board should
14 consider in reaching a decision in this
15 matter, and then Mr. Nelson will address some
16 of the economic principles, data and public
17 interest issues that the Board should
18 consider.

19 AECC supports the NITL proposal
20 for reasons discussed in our written comments.

21 Today however, we are focusing on
22 an overarching issue. The railroads

1 opposition to the NITL proposal should be
2 rejected because they want the Board to ignore
3 the fact that railroads have achieved revenue
4 adequacy, and that during the past few years,
5 they have enjoyed earnings substantially above
6 competitive levels, that is supra-competitive
7 returns on earnings.

8 Mr. Nelson will describe these
9 supra-competitive earnings in further detail
10 in a few minutes.

11 Achieving revenue adequacy
12 represents a dramatic change from the
13 situation that prevailed in the U.S. railroad
14 industry when the Staggers Act was passed.

15 In 1980, the ICC's revenue
16 adequacy determination found that 34 of the 37
17 Class I railroads were revenue inadequate.
18 The achievement of revenue adequacy that now
19 has been revealed by the Board's findings, may
20 fairly be regarded as one of the great success
21 stories of Federal policy in modern times.

22 But revenue adequacy was only one

1 of the goals of the Staggers Act. The Act
2 established a national rail transportation
3 policy that set several goals, the first of
4 which was to allow to the maximum extent
5 possible, competition and the demand for
6 services to establish reasonable rates for
7 transportation by rail.

8 During the past three decades, the
9 ICC and the Board focused on another goal of
10 the transportation policy, to allow rail
11 carriers to earn adequate revenues, as
12 determined by the Board.

13 In upholding this approach, the
14 Courts explicitly accepted the goal of
15 achieving revenue adequacy as a valid reason
16 for the Board to refrain from exercising its
17 powers to promote competitive alternatives,
18 thereby permitting the exercise of rail market
19 power.

20 Just to cite two examples, in
21 Central State's Enterprises versus ICC in
22 1985, the 7th Circuit upheld the ICC's denial

1 of a request for reciprocal switching, because
2 it would have an adverse effect on a revenue
3 inadequate railroad.

4 Similarly in Coal Exporter's
5 Association versus U.S., the D.C. Circuit said
6 in 1984 that, "Use of market power is
7 justified where needed for revenue adequacy."

8 However, there can be no doubt
9 that Congress expected the Board to take
10 effective steps to curb any supra-competitive
11 earnings, after revenue adequacy was achieved.

12 The rail transportation policy
13 expressly calls for the Board to maintain
14 reasonable rates where there is an absence of
15 effective competition and where rail rates
16 provide revenues which exceed the amount
17 necessary to maintain the rail system and to
18 attract capital.

19 So, now, after three decades, we
20 are at the point where the public interest
21 requires that the Board move away from
22 promoting railroad earnings, and toward using

1 the tools at its disposal, to curb supra-
2 competitive earnings where they occur.

3 The railroads argue that the
4 policy judgements the ICC made in an earlier
5 era, when virtually the entire rail industry
6 lacked adequate revenues, are written in stone
7 and cannot now be changed to reflect changed
8 circumstances. No Court has ever said that
9 and no Court ever will.

10 On the contrary, the Courts made
11 clear that they were holding only that the
12 regulatory policies adopted by the ICC later
13 by the Board, were permissible within the
14 discretion granted by Congress under the
15 circumstances that then existed, as the NITL
16 has discussed in its presentation today.

17 Today, railroads have achieved
18 revenue adequacy and more. This demands a
19 different approach to accommodate the policies
20 of the Act.

21 As Mr. Nelson will explain in a
22 few moments, supra-competitive earnings have

1 escalated rapidly, are now in the billions of
2 dollars annually.

3 There is no public interest
4 justification for allowing railroads to
5 exercise their market power, to extract these
6 supra-competitive earnings from shippers.

7 On the contrary, the reduction or
8 elimination of such earnings should be viewed
9 as a public benefit.

10 The Board properly can and should
11 reflect the changed circumstances stemming
12 from the achievement of revenue adequacy in
13 changes to its policies and practices.

14 Congress has clearly indicated
15 that competition is an appropriate, in deed,
16 a favored means to restrain railroads from
17 extracting supra-competitive earnings from
18 their customers.

19 The rail transportation policy
20 repeatedly identifies competition as a way to
21 curb market power. It says, "To allow
22 competition and the demand for services, to

1 establish reasonable rates to transportation
2 by rail." It say, "To foster a rail system
3 with effective competition among rail carriers
4 and to avoid undue concentrations of market
5 power."

6 Congress has given the Board tools
7 to use, to foster railroad competition.

8 With revenue adequacy achieved and
9 railroads earning billions in supra-
10 competitive profits, the time has come for the
11 Board to begin to exercise its power granted
12 by Congress, to require rail carriers to enter
13 into reciprocal switching agreements "where
14 such agreements are necessary to provide
15 competitive rail service".

16 The ability of a railroad to
17 extract supra-competitive earnings from
18 captive shippers can be constrained by a
19 mechanism that gives such shippers a rail
20 transportation alternative. The NITL proposal
21 provides such a mechanism.

22 Mr. Nelson will now explain in

1 further detail, the economic and public
2 interest bases for AECC's position.

3 MR. MILLS: Is this one? Good
4 afternoon, Chairman Elliott, Vice Chairman
5 Begeman.

6 I'm going to be talking about the
7 Board's recent revenue adequacy determinations
8 and some of their implications for the Board's
9 competition policies, including the Board's
10 consideration of NITL's competitive switching
11 proposal.

12 Before getting into the numbers
13 though, I'd like to talk a little bit about
14 two principles of competitive markets that are
15 part of the theory of constrained market
16 pricing or CMP.

17 CMP has guided the Board and the
18 ICC regarding the permissible exercises of
19 market power by railroads essentially since
20 the time of the Staggers Act.

21 To keep everybody from falling
22 asleep, I'll try to keep the theory part

1 short.

2 The first competitive market
3 principle is that in a competitive market, a
4 firm is unable to sustain excessive profits.
5 A firm that achieves big profits unavoidably
6 draws the attention of competitors and
7 potential competitors who try to find ways to
8 capture those high profits for themselves, by
9 innovating to find even better ways to serve
10 those markets.

11 This could include things like
12 development of lower cost methods of
13 production and offering more attractive price
14 service options to customers.

15 This is a fundamental part of the
16 way competitive markets limit the market power
17 of individual firms and produce efficiency in
18 what economists call the allocation of
19 resources throughout the economy.

20 Implementing this principle in the
21 rail industry is challenging for at least two
22 reasons.

1 First, the industry has some
2 amount of -- excuse me, some of the properties
3 of a natural monopoly, so the exercise of some
4 amount of market power is needed to cover
5 costs if public subsidies are to be avoided.

6 Second, various practical
7 considerations make it difficult or impossible
8 for new competitors to actually enter the
9 industry. This is known as barriers to entry.

10 The Board's standalone cost test
11 deals with these issues for individual rates
12 by analyzing the economics of a hypothetical
13 new railroad and imposing a bright line limit
14 on allowable differential pricing at the exact
15 point where the earnings of the new railroad,
16 after paying all expenses, just cover the cost
17 of capital it uses.

18 This is how the Board already
19 implements the competitive market and CMP
20 principle that excessive profits not be
21 allowed.

22 All else equal, net earnings that

1 just cover the costs of capital reflect the
2 highest level of differential pricing, that is
3 consistent with the public interest, while
4 providing a railroad with access to the
5 capital it needs.

6 We refer to earnings in excess of
7 that level as supra-competitive earnings.

8 The second principle of
9 competitive markets since CMP is that cross-
10 subsidies are to be avoided. In a competitive
11 marketplace, firms face continuous incentives
12 to either improve the performance of or divest
13 under-performing assets or lines of business.

14 In the Board's standalone cost
15 test, this principle is reflected in the
16 shippers ability to select the traffic to be
17 served by the hypothetical railroad. If the
18 shipper can identify non-issue traffic, that
19 profitably can be served by the hypothetical
20 railroad it proposes, it can hold down the
21 amount of differential pricing needed for the
22 hypothetical railroad to cover its cost of

1 capital.

2 Even if other portions of the
3 defendant railroad don't cover their cost of
4 capital, the portions that do are not and
5 should not be allowed to cross-subsidize the
6 portions that don't.

7 So, the things to remember are no
8 supra-competitive earnings and no cross-
9 subsidies.

10 For anyone who hasn't heard enough
11 of the theories, there is a very informative
12 presentation in the consensus, verified
13 statement of economists supporting the
14 principles of constrained market pricing,
15 which was submitted to the ICC in June 1983,
16 in Docket No. EP-347 of the Coal Rate
17 Guidelines nationwide.

18 This verified statement was signed
19 by 16 pre-eminent economists and addressed the
20 ICC's plans for implementing CMP under the
21 Staggers Act.

22 I'm glad to have been a student of

1 one of the signatories, Professor Ann
2 Friedlaender of MIT.

3 We have a chart to put up. This
4 chart was developed from information the Board
5 recently provided in its updates of the rail
6 revenue adequacy findings for 2010, 2011 and
7 2012.

8 The three lines depict different
9 groupings of the data. It's probably hard to
10 see, but the green line shows supra-
11 competitive earnings for the Class I rail
12 industry as a whole.

13 Using the Board's methodology, the
14 earnings of the Class I railroads as a group
15 did not exceed the level needed to cover the
16 estimated cost of capital in 2010, but did
17 exceed that level by about \$500 million in
18 2011, and over \$1.3 billion in 2012.

19 This doesn't show the full extent
20 of supra-competitive earnings however, because
21 it does not control for the cross-subsidy
22 issue I mentioned a moment ago.

1 In fact, the four largest Class
2 I's, UP, BNSF, NS and CSX, collectively
3 achieved supra-competitive earnings of over
4 \$800 million in 2011, and over \$1.6 billion in
5 2012. This is shown by the red line in the
6 chart.

7 To put this in perspective, over
8 14 percent of the \$11.4 billion of net income
9 reported by these four railroads in 2012
10 represents supra-competitive earnings that in
11 excess of the amount required to cover their
12 cost of capital and therefore, are
13 inconsistent with CMP and with the public
14 interest.

15 Supra-competitive earnings by the
16 big four are larger than the values on the
17 green line because the green line implicitly
18 includes a cross-subsidy from the big four to
19 the three smaller Class I's, which did not
20 achieve supra-competitive earnings during that
21 time.

22 For the big four railroads which

1 collectively account for about 88 percent of
2 rail net investment base and over 91 percent
3 of the net operating income of the Class I
4 railroads, the data plainly shows supra-
5 competitive earnings are substantial and
6 trending upwards.

7 To test the validity of this
8 conclusion, I performed one additional
9 analysis to account for two factors that may
10 be affecting the big four totals.

11 First, because BNSF data no longer
12 are included in the cost of capital
13 determination, the supra-competitive earnings
14 values implicitly assume that BNSF's cost a
15 capital is the same as that of the three
16 reporting railroads, UP, NS and CSX.

17 Second, the totals have been
18 affected by transitory changes the Board made
19 in the permissible treatment of the write up
20 of BNSF asset values stemming from its
21 acquisition by Berkshire Hathaway.

22 To make sure these factors are not

1 the cause of the finding of substantial and
2 upward trending supra-competitive earnings, I
3 considered only the earnings data for UP, NS
4 and CSX as a group.

5 These data shown in blue in the
6 chart, indicate that supra-competitive
7 earnings began at a low level in 2010, but
8 still escalated to over \$1 billion in 2012.

9 Almost 15 percent of the \$7.8
10 billion of net income reported by these three
11 railroads in 2012 represents supra-competitive
12 earnings.

13 In short, the findings of supra-
14 competitive earnings by the big railroads that
15 I have presented are not an artifact of the
16 Board's treatment of BNSF's asset base or cost
17 of capital during this time.

18 Quarterly data for 2013 presented
19 on the Board's website suggests that this
20 trend has continued. Net revenue for the big
21 four appears to have increased by over \$900
22 million, relative to 2012. So, there is no

1 reason to think that the issue of supra-
2 competitive earnings is going to remedy itself
3 without Board action.

4 The existence of an upward trend
5 in supra-competitive earnings indicate that
6 the Board currently is not succeeding in
7 applying fundamental CMP principles to the
8 large railroads.

9 The application of those
10 principles to hypothetical railroads and
11 individual rate proceedings is a starting
12 point, but most shippers won't ever file a
13 rate case at the STB, either because they
14 don't qualify to be able to do so, or are
15 dissuaded by the cost, time and uncertainty
16 associated with rate case procedures.

17 Even if there were more challenges
18 to individual rates, the Board currently has
19 no procedures for applying CMP principles to
20 the overall performance of actual railroads,
21 and the evidence demonstrates that the largest
22 railroads now exercise more market power than

1 is needed for them to achieve returns that
2 fully cover their cost of capital.

3 From an economic perspective, the
4 time has come for the Board to treat the
5 policy objective of revenue adequacy as having
6 been achieved, at least for the largest
7 railroads, and to now devote effort to
8 remediating the substantial public interest
9 harms that flow from the sustained occurrence
10 of supra-competitive earnings.

11 The NITL proposal for liberalized
12 competitive access is the kind of measure that
13 current conditions require. While the
14 railroads in this proceeding have objected to
15 the curtailment of differential pricing that
16 could accompany the competitive switching
17 proposal, the data say that such a curtailment
18 would be a public benefit.

19 Even the limitation of the
20 competitive switching proposal to higher rated
21 traffic is consistent with CMP because that is
22 the traffic that is least elastic for which a

1 change in price will produce the smallest
2 impact on resource allocation.

3 The same elasticity consideration
4 that makes it appropriate to engage in
5 differential pricing in the first place, also
6 makes it appropriate to apply rate compression
7 to higher rated traffic, as would occur under
8 the NITL proposal.

9 More generally, the Board's
10 revenue adequacy findings support the
11 proposition that the time has come for the
12 Board to relax the restrictive posture it has
13 taken in the past regarding competitive
14 access.

15 Beyond the curtailment of supra-
16 competitive earnings that can be provided by
17 competitive access, introduction of market
18 forces can produce important benefits for
19 efficiency and service quality.

20 The Boards' own study performed by
21 Christensen Associates, showed that the mega-
22 mergers of the 1990's produced unanticipated

1 harmful effects on railroad efficiency and
2 cost. Likewise, multiple episodes of service
3 quality problems on the big four have imposed
4 huge burdens on rail customers and on the
5 economy as a whole.

6 The data say it is past time for
7 the Boards to turn loose, the dogs of
8 competition, at least on the big four, to
9 allow market forces to finally play the role
10 envisioned for them over 30 years ago.

11 CHAIRMAN ELLIOTT: Are you done,
12 this group? Why don't we continue with the
13 interested agricultural parties? Ms. Clark?

14 MS. CLARK: Thank you. Good
15 afternoon, Chairman Elliott and Vice Chairman
16 Begeman. My name is Sharon Clark, and I am
17 Senior Vice President of Transportation and
18 Regulatory Affairs for Perdue Agri Business,
19 a domestic and international grain and
20 commodity trading and processing company,
21 based in Salisbury, Maryland.

22 I am also a member of the National

1 Grain and Feed Association's Board of
2 Directors and Executive Committee.

3 I appear today on behalf of the
4 interested agricultural parties, a broad-based
5 consortium of agricultural organizations, from
6 producers to end-users, including the NGFA.

7 The other organizations comprising
8 the group are listed and described in our
9 filing.

10 I am accompanied by Thomas Wilcox
11 of the law firm of GKG Law PC, who helped
12 prepare and submit the groups' comments. He
13 is available to assist in responding to any
14 questions the Board may have about our
15 submissions.

16 The interested agricultural
17 parties appreciate the opportunity to present
18 their collective thoughts on this proceeding,
19 and the National Industrial Transportation
20 Leagues competitive switching proposal.

21 Access to rail transportation via
22 efficient and cost-effective switching between

1 carriers is of extreme importance to
2 agricultural users, because of the nature of
3 our industry and its rail transportation
4 patterns.

5 First, grains, oil seeds, feed
6 ingredients and other agricultural commodities
7 are produced in diverse geographic locations,
8 rather than centralized production centers.

9 Rail movements from these diverse
10 production areas to destination customers
11 vary, and are influenced heavily by
12 fluctuating seasonal and weather-related
13 conditions, as well as domestic and export
14 market demand.

15 For these reasons, agricultural
16 commodity shipments are characterized by
17 multiple origin and destination payers, which
18 differ markedly from the comparatively static
19 origin and destination payers of many non-
20 agricultural movements.

21 Supply and demand dynamics change
22 shipping patterns from year to year,

1 highlighting the need for competitive
2 switching to access different markets. In
3 addition, in years like this, serious
4 disruptions in rail service reinforce the
5 importance of having the flexibility to shift
6 traffic, when possible, between different rail
7 carriers, to keep businesses operational and
8 meet customer needs.

9 Agricultural producers and
10 shippers now rely primarily upon four Class I
11 carriers to haul the vast majority of grain
12 and oil seeds shipped by rail.

13 In 2001, according to the U.S.
14 Department of Agriculture, these four carriers
15 originated 85 percent of grain and oil seed
16 rail traffic, compared to only 53 percent in
17 1980.

18 The lack of effective, competitive
19 switching rules limits more extensive access
20 to markets for agricultural commodities and
21 the ability to shift traffic between rail
22 carriers when necessary.

1 These characteristics of today's
2 rail industry and the transportation needs of
3 agricultural markets explain why the
4 interested agricultural parties are adamant
5 about achieving a more competitive rail
6 environment consistent with free enterprise
7 principles.

8 The interested agricultural
9 parties commend the National Industrial
10 Transportation League for submitting its
11 petition, and concur with its overall premise,
12 that the Board can and should replace its
13 existing rules, implementing the Board's
14 authority to order a rail carrier to provide
15 reciprocal switching at facilities that are
16 captive to that carrier.

17 We believe NITL's proposal
18 provides a workable framework for developing
19 new rules and regulations, but as I will
20 explain momentarily, we think some aspects of
21 the proposal should be modified, if it is to
22 be more accessible and useable by agricultural

1 rail shippers.

2 We do not believe the
3 modifications we propose would unduly burden
4 the railroads or other captive rail shippers.

5 Fully responding to all of the
6 Board's requests for empirical data was not
7 possible because of the unavailability of
8 data, as well as the limited time and
9 resources available to the interested
10 agricultural parties for this proceeding.

11 Never the less, our analysis
12 involved more than 44,000 individual records,
13 comprising more than three-million rail
14 shipments of agricultural products, totaling
15 more than \$9.2 billion in freight revenue,
16 sufficient to provide a rough estimate of the
17 impact of NITL's proposal on shipments of
18 commodities listed in the NGFA's rail
19 arbitration rules.

20 To summarize, our analysis show
21 the following:

22 First, the raw 2011 waybill data

1 indicates that at most, only around six
2 percent of these agricultural product carloads
3 theoretically could qualify for the conclusive
4 presumption of market dominance, when a rate
5 was 240 percent or more of variable cost.

6 But in reality, the figure is much
7 less than six percent, when the raw waybill
8 data is more closely examined, because of the
9 exclusion of movements that don't qualify for
10 various reasons, such as short lines involved
11 in the haul movements, rail contract movements
12 and shipments of exempt commodities.

13 Second, we did not attempt to
14 quantify how many agricultural shippers could
15 meet the alternative presumption of the
16 incumbent railroad hauling 75 percent or more
17 of a shipper's traffic, because such an
18 analysis would have entailed an expensive and
19 time consuming special study.

20 However, as we have explained in
21 our opening submission, we believe this
22 alternative has little relevance or

1 application to agricultural rail shippers,
2 since very few shipments of light commodities
3 are railed from the single origin to only one
4 destination in a single year.

5 Third, of the agricultural
6 commodities shipments analyzed that exceeded
7 the 240 percent threshold, many do not meet
8 either of the two criteria of NITL's second
9 conclusive presumption, namely that the
10 alternate carrier be a reasonable distance
11 from the shipper's facility.

12 For example, none of the wheat and
13 barley shippers in the State of Montana could
14 meet this presumption of being within the
15 boundaries of an existing terminal or 30 miles
16 from a working interchange.

17 The interested agricultural
18 parties therefore, join NITL and other
19 parties, in urging the Board to initiate a
20 formal rulemaking proceeding on revised rules,
21 implementing the Board's statutory authority
22 to order a carrier to provide competitive

1 switching.

2 But in doing so, we recommend that
3 several changes be made to the NITL proposal,
4 so that it's more accessible and relevant to
5 agricultural rail shippers.

6 First, the revenue to variable
7 cost threshold that establishes one of the
8 conclusive presumptions of market dominance
9 for purposes of obtaining a competitive
10 switching order should be reduced to 180
11 percent, to match the statutory jurisdictional
12 threshold. This recommendation has also been
13 made by USDA.

14 Second, many agricultural
15 commodity shippers cannot meet the conclusive
16 presumptions for the reasonable distance
17 component of the NITL proposal, particularly
18 in the western regions of the country.

19 For that reason, we recommend that
20 the Board expand the distance that creates the
21 conclusive presumption and adopts standards
22 that allow individual captive agricultural

1 rail users to demonstrate on a case-by-case
2 basis, that their facility is a reasonable
3 distance from a working interchange point, if
4 the R/VC ratio exceeds the regulatory
5 threshold.

6 Again, this recommendations
7 reflects the vast geographic dispersion of
8 agricultural production and utilization, and
9 the longer distances that exist to an
10 interchange point in rural America,
11 particularly in the west.

12 In these situations, shippers may
13 be able to make a case economically or
14 operationally, that a greater distance should
15 apply.

16 Third, rules that create a right
17 to competitive switching will have little
18 practical use to rail users unless there is an
19 access fee that makes it economically feasible
20 to use an alternative railroad.

21 While the interested agricultural
22 parties did not allocate a specific access fee

1 proposal, we believe it should be cost based,
2 with a reasonable return for the incumbent
3 railroad.

4 For instance, many current
5 railroad imposed switch charges can be higher
6 than \$500 per car, which in some cases, can be
7 approximately five times the variable cost for
8 providing the switch service.

9 Another example is the NITL
10 Conrail reciprocal switching agreement, which
11 was reached in 1999, which capped reciprocal
12 switching rates at \$250 per car for a five
13 year period, but reciprocal switching rates
14 published by eastern Class I's have been on an
15 upward spiral since 2004, as have those of the
16 western carriers.

17 Cost based access fees would limit
18 the current ability of railroads to exclude
19 captive agricultural rail users from existing
20 markets, by setting switch charges at levels
21 that limit access to markets or effectively
22 make markets too expensive to reach.

1 Fourth, we believe competitive
2 switching fee should vary based upon unit
3 size, such as carloads, unit trains, shuttle
4 trains and other rail shipments.

5 The current reciprocal switching
6 rates on Class I's are the same, regardless of
7 unit size, even though differential pricing is
8 employed elsewhere. In our view, this one-
9 size-fits-all approach won't work for a
10 competitive reciprocal switching model.

11 Finally, we believe estimating the
12 ultimate impact of adopting the NITL proposal
13 on railroad revenues, rail rates and railroad
14 operations, even with a modification suggested
15 by the interested agricultural partners, is
16 made more difficult, simply because there is
17 no guarantee that railroads will actually
18 compete and line haul rate levels will decline
19 if competitive switching is established.

20 For this reason, we believe that
21 wherever a competitive switching is ordered,
22 the Board should not adopt a conclusive

1 presumption that effective competition exists,
2 and therefore, that the STB has no
3 jurisdiction over rate levels.

4 Instead, the Board should make
5 market dominance determinations on a case by
6 case basis.

7 Regarding rail rates, the
8 interested agricultural parties take this
9 opportunity to commend the Board for
10 instituting a separate proceeding to examine
11 ways to improve its procedures available to
12 grain rail users, to challenge rates they
13 believe are unreasonable.

14 We believe it is essential for the
15 Board to improve its rail rate reasonableness
16 rules for agricultural shippers, to not only
17 consider the reasonableness of rates where
18 competitive switching is ordered if
19 circumstances warrant, but also to protect
20 captive shippers who cannot meet the standards
21 for competitive access from unwarranted rate
22 increases.

1 In conclusion, the interested
2 agricultural partners believe that rail
3 carriers should not have a free hand to deny
4 captive agricultural shippers access to
5 markets through absolute closures of
6 intersection points or by pricing switch
7 charges beyond any justifiably reasonable
8 economic level.

9 Therefore, we support the
10 institution of a rulemaking on revised
11 competitive switching rules that includes the
12 recommendation submitted in our filings.
13 Having such rules in place to enhance
14 competitive switching of movements is integral
15 to maintaining a national rail freight network
16 and to preserving the competitive fabric of
17 U.S. agricultural and the nation's economy.

18 We appreciate this opportunity to
19 express our views and recommendations on this
20 important proceeding, and would be pleased to
21 respond to any questions the Board may have.
22 Thank you.

1 CHAIRMAN ELLIOTT: Thank you, Ms.
2 Clark. We'll now hear from Mr. Mills from the
3 joint coal shippers.

4 MR. MILLS: My name is Chris Mills
5 and I represent four electric utilities who
6 have named themselves the joint coal shippers
7 for purposes of this proceeding.

8 These utilities, three of them
9 have power plants that burn western coal and
10 that are potentially -- potentially could use
11 competitive switching, depending on the
12 parameters that may ultimately be adopted by
13 the Board, if it adopts NITL's proposal in
14 some form, and one of which is an eastern coal
15 user, for the power plant of Florida.

16 The four are Energy Services,
17 Incorporated, Kansas City Power and Light
18 Company, Seminole Electric Power Cooperative
19 and Wisconsin Electric Power Company, which
20 does business as WE Energies.

21 The joint coal shippers principle
22 concern involving this proceeding, relates to

1 the question that Vice Chairman Begeman asked
2 the last -- the last question she asked the
3 NITL Panel this morning, and that relates to
4 the inter-play between a possible -- possible
5 availability of a joint switching array --
6 competitive switching remedy and the rate case
7 remedy, maximum rate regulation.

8 The joint coal shippers do not
9 really have enough information at this point
10 to either support or oppose the NITL proposal,
11 because there are too many uncertainties, as
12 to the distance over which switching might be
13 available and the level of the incumbent
14 switching charge.

15 But the goal -- the joint coal
16 shippers do oppose any change in the Boards'
17 current qualitative market dominance standards
18 and maximum rate cases involving origin to
19 destination service, as a result of the
20 adoption of any competitive switching remedy.

21 In other words, the mere
22 availability of a reciprocal switching remedy

1 should not establish a presumption that the
2 incumbent carrier lacks market dominance over
3 any particular movement, and we are not
4 absolutely certain that the Board intended
5 there be such a presumption, but it is at
6 least suggested by the Board, and it's a
7 language on page six of its July 25, 2012
8 decision, which initiated this proceeding.

9 As far as we are aware, no part of
10 this proceeding has advocated that any new
11 switching rules that may be adopted by the
12 Board should be viewed as a substitute for a
13 full market dominance analysis in an origin to
14 destination rate case, that is a rate case
15 that might be brought if you have a -- an
16 incumbent has a single-line route and a -- and
17 the shipper has available switching remedy.

18 The competitive railroad is able
19 to use the switching service that provides
20 competitive rate and the shippers are
21 satisfied with the rate level. The shipper
22 should remain free to bring a maximum rate

1 case against the incumbent for the full origin
2 or destination movement, and the fact that a
3 switch charge has been offered, should not be
4 determinative of market dominance, but rather
5 a -- one factor to be considered.

6 The current market dominance
7 standards in rate cases require the shipper to
8 make a prima facie case. There is no inter --
9 no effective inter-modal or intra-modal
10 competition for the movement at issue, after
11 which, the burden shifts to the defendant
12 railroad to establish that there is, in fact,
13 a competitive alternative that effectively
14 constrains its rate.

15 If a competitive switching option
16 exists, it should be treated like any other
17 potential competitive alternative, in valuing
18 market dominance in a rate case involving the
19 incumbents origin to destination service.

20 That would mean for example, that
21 under the current standards as they've been
22 modified by the recent decision in the M&G

1 Polymers case, the rate offered by a second
2 railroad that has switching service available
3 at the origin or the destination, including
4 the incumbent switching charge, would serve as
5 the limit price for purposes of determining in
6 part, whether effective competition exists.

7 In the joint coal shippers
8 comments, which were filed in March of last
9 year, at pages 13 and 14, they presented four
10 scenarios where the mere existence of a
11 possible switching alternative at origin or
12 destination would not necessarily provide
13 effective competition under the Board's
14 current market dominance standards, and with
15 those situations in mind, again, we submit
16 that the Board should make it clear, if it
17 proceeds with the rulemaking on NITL's
18 proposal, that the market dominance rules in
19 maximum rate cases would not be altered.

20 Thank you.

21 CHAIRMAN ELLIOTT: Thank you, Mr.
22 Mills.

1 VICE CHAIRMAN BEGEMAN: Ms. Clark,
2 you mentioned the service difficulties in
3 certain areas of the country, and efforts
4 between the carriers and shippers, to try to
5 get grain, feed, and supplies moving.

6 Could you give us a little more
7 background into what your experience has been?
8 Are you being affected by the winter service
9 crisis or --

10 MS. CLARK: Yes, actually we
11 started seeing, in fact, National Grain and
12 Feed Association members began seeing
13 declinations in service as early as last
14 October, on a few of the Class I carriers, and
15 those folks of us with competitive locations
16 currently, with reciprocal switching, have had
17 to use that as an option, just in order to
18 keep plants running, to keep us supplied with
19 goods, and we've seen a lot of what -- of
20 operational shifts in the last six months,
21 both in the east and the west, because certain
22 Class I's were providing a better service

1 profile and had access to markets that could
2 keep certain processors, feed mills, export
3 market supplied in what has been a very
4 challenging environment.

5 So, it lends itself to speaking,
6 how a competitive access scenario for those
7 captive shippers could also benefit, not only
8 from a price perspective, which has been kind
9 of primarily the focus of discussion today,
10 but also from a service and market access
11 perspective.

12 I think we've proven that in
13 space, over the last six months with the types
14 of issues we've been dealing with.

15 VICE CHAIRMAN BEGEMAN: And have
16 the carriers been receptive to working with
17 you?

18 MS. CLARK: Well, as I mentioned,
19 the locations we've -- we personally have
20 exercised our reciprocal switching rights. We
21 obviously weren't captive. So, it's an
22 option, and we know about the locations that

1 have not -- that have reciprocal switching,
2 that are not captive, but have not exercised
3 those rights in several years, who this year
4 are exercising those rights, and I think all
5 the carriers are trying to work together to
6 ensure that, you know, a chicken doesn't have
7 to go on a diet, necessarily.

8 VICE CHAIRMAN BEGEMAN: You
9 certainly provided a list of areas that you
10 would like the Board to further explore
11 through rulemaking, to modify NITL's proposal,
12 so that it is more accommodating to AG
13 interests. I'm curious to know if ACC is
14 satisfied with the proposal that's been put
15 forward, or if you have suggestions that you
16 think need to be considered to improve it?

17 MR. VON SALZEN: I think ACC
18 recognizes, and we said in our reply filings,
19 that there are certain aspects of the NITL
20 proposal that could probably use some fine-
21 tuning, in dealing with unit train service,
22 and there may be some other areas like that.

1 The basic structure of the
2 proposal, we think is reasonable, but yes, I
3 think in a rulemaking proceeding, we might
4 have some constructive suggestions to make.

5 CHAIRMAN ELLIOTT: Just a couple
6 of questions. First of all, I noted in
7 reading through some of the comments,
8 including I think the interested AG parties'
9 comments, that some of the shippers believe
10 that there may be some issues, with respect to
11 the railroads, adequately competing to get
12 this business, and if that's, in fact the
13 case, and if that's your experience, would
14 this proposal made by NITL, to introduce
15 competition be effective? And that's not just
16 you, but to the panel.

17 MS. CLARK: Well, as we mentioned
18 in our comments today, we do think that the
19 STB needs to continue to take an active role
20 in reviewing what's going on with these
21 different scenarios, as they're presented on
22 a case by case basis.

1 We also think that the rulemaking
2 on the reasonableness of grain rates and
3 providing a mechanism there to more
4 effectively challenge rates in our rate case,
5 is very important in this scenario that we're
6 discussing, that's another option.

7 So, on balance, I think we do have
8 concerns, just as you would with any new
9 framework that is going to be effective right
10 out of the gate. However, I think people have
11 pointed to examples through the hearing so far
12 today, things like the shared services areas
13 that were created after Conrail.

14 We actually have facilities in
15 some of those shared access areas, and I will
16 say that they had their hiccups at the
17 beginning, but they've smoothed out over the
18 years, and so, it's just something that I
19 think we're going to have to work together, to
20 make sure we have an effective process in
21 place and that we truly have ensured
22 competition.

1 CHAIRMAN ELLIOTT: Thank you. One
2 further question.

3 I noted that AECC, in their
4 comments, mentioned, and I think Mr. Nelson
5 continued upon the theme that the railroads,
6 in your eyes, have reached revenue adequacy,
7 or at least are very close, and maybe that
8 it's time to introduce this type of
9 competition as a mechanism to reach what is
10 revenue adequacy, if they are, achieving super
11 profits in this situation, at this point in
12 time?

13 Do you see this proposal, the NITL
14 proposal as an effective way of the Board
15 dealing with revenue adequacy, if in fact, it
16 is reached, as you, I think mentioned in your
17 testimony?

18 MR. NELSON: Yes, I would see that
19 type of proposal as being effective.

20 The thing to remember is that
21 these super competitive earnings are above and
22 beyond what the railroads legitimately need to

1 cover their cost of capital, and they should
2 not be afforded the same type of weight by the
3 Board, as the earnings needs of the railroads
4 that fall short of the revenue adequacy
5 standard.

6 So, when they pass the revenue
7 adequacy threshold, it really becomes a public
8 interest problem for the Board to address, to
9 sort of reign it in, because I don't want to
10 get into a big economics lecture, but it sort
11 of messes up the allocation of resources in
12 the economy, if you have one segment where the
13 earnings are easy because the -- you know,
14 this spigot on the exercise of market power
15 has been left too far open and investment
16 dollars see the choice between easy money
17 there and sort of the more harder -- harder
18 gains to get, by investing elsewhere in the
19 economy, where there is real competition.

20 So, there is very tangible harms
21 that come from allowing sustained super
22 competitive earnings, so, it's not so much

1 that this specific proposal is the exact thing
2 that's needed to remedy that, but a more open
3 view by the Board and a more accepting posture
4 by the Board, to the whole family of
5 competitive access remedies, I think is called
6 for by the movement into the realm of super
7 competitive earnings.

8 CHAIRMAN ELLIOTT: And if we --

9 MR. VON SALZEN: Can I just --

10 CHAIRMAN ELLIOTT: Sure, go ahead.

11 MR. VON SALZEN: If I can just add
12 to that. Because this is -- this NITL
13 proposal is very narrowly crafted. This is,
14 you know -- you've heard all sorts of claims
15 about what it might do and so forth and so on,
16 but what it's actually intended to do is very
17 narrow.

18 We are not suggesting that that
19 remedy alone is going to solve the problem of
20 super competitive earnings in the big four
21 railroad industry.

22 But every journey of 1,000 miles

1 starts with a single step, and this is a
2 productive step that the Board can and should
3 be considering now, because of the change in
4 the economic environment of the railroad
5 industry.

6 This is not 1980 anymore, but it
7 is a world that Congress contemplated when it
8 wrote the Staggers Act in 1980, the revenue
9 adequacy would be achieved and when it was,
10 then competition is one of the things, in
11 fact, the most important thing I think, that
12 the rail transportation policy says is it the
13 job of this Board to foster.

14 CHAIRMAN ELLIOTT: And if we
15 hypothetically, did impose this on that basis,
16 what would we do, at the part where we
17 decreased the spigot, as you put it, and the
18 railroads fall down to a number where they're
19 not earning these types of profits?

20 I mean, how would we control that?

21 MR. NELSON: Through your ongoing
22 authority over all forums of competitive

1 access, individual rate proceedings, to some
2 extent, but it's a balancing act that the
3 Board is going to be faced with, going
4 forward, now that the revenue adequacy
5 threshold has either been attained or is close
6 to being attained by the remainder of the
7 Class I's.

8 Where in the past, the posture of
9 the Board has, at the direction of Congress,
10 been to foster the attainment of revenue
11 adequacy. Once it's attained, then you have
12 a balancing act, where you can't attain it too
13 much and you don't want to push it below, but
14 you don't want to let it run wild up above
15 either.

16 So, it's going to be an ongoing
17 balancing act, where you would need to be
18 monitoring and keeping track of, you know, how
19 much traffic was actually able to make use of
20 pro-competitive initiatives that you might
21 implement, because AECC certainly isn't
22 advocating pushing things below the revenue

1 adequacy level, it's striking the right
2 balance of competition, so that the super
3 competitive earnings don't accrue on any kind
4 of sustained basis.

5 CHAIRMAN ELLIOTT: If we set the
6 number, instead of 240 at RSAM, would that get
7 us to that type of balancing that we might
8 need?

9 MR. NELSON: I'll confess, I
10 haven't really considered that question enough
11 to give you a good answer here. That might be
12 the kind of thing that would be addressed in
13 a rulemaking proceeding or something, or some
14 further opportunity to think about that one.

15 CHAIRMAN ELLIOTT: I won't put you
16 on the spot, if you haven't thought about it.
17 Any further questions?

18 I don't have any further
19 questions. I want to thank everyone for
20 coming today. Thank you for your excellent
21 testimony and all your hard work, and also
22 thank you, to our Board employees and Court

1 Reporter for their work today.

2 This will end this portion of the
3 hearing and we'll reconvene here at 9:30 a.m.

4 Just as a reminder, remember to
5 check in, if you're one of the parties
6 participating tomorrow. So, thank you very
7 much.

8 (Whereupon, the above-entitled
9 matter concluded at approximately 2:00 p.m.)

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C E R T I F I C A T E

This is to certify that the foregoing transcript

In the matter of: PETITION FOR RULEMAKING TO ADOPT
REVISED COMPETITIVE SWITCHING RULES

Before: STB

Date: 03-25-14

Place: Washington, DC

was duly recorded and accurately transcribed under
my direction; further, that said transcript is a
true and accurate record of the proceedings.



Court Reporter

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Testimony of Phil Ireland: Exhibits

March 25, 2014

**Before the Surface Transportation Board
In the Matter of Ex Parte No. 711, Petition for Rulemaking to Adopt Revised
Competitive Switching Rules**

Exhibit 1: Canadian Rail Network



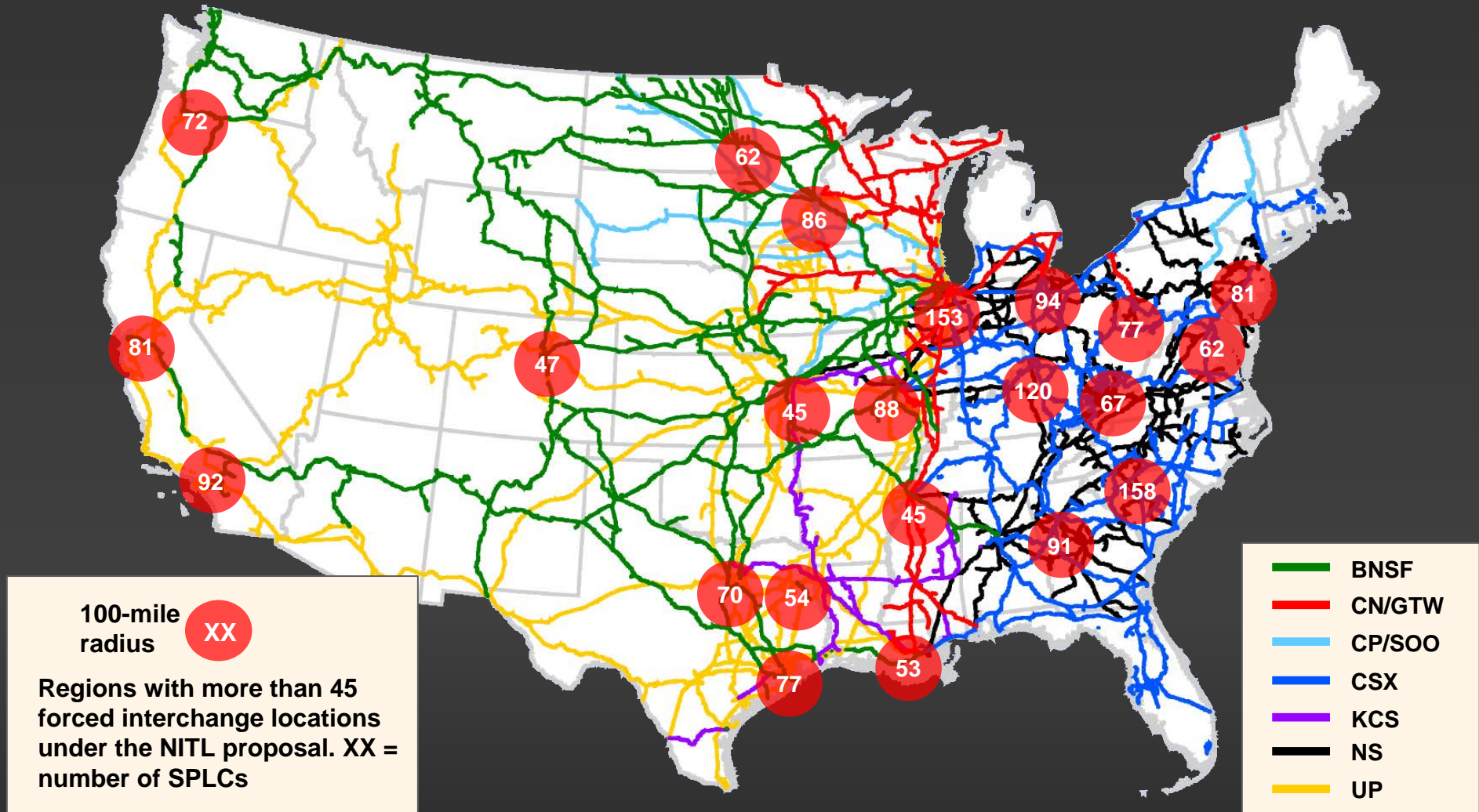
Source: Transport Canada.

Exhibit 2: U.S. Rail Network



*Non-primary Class I rail lines, as well as regional and shortline rail lines.
Source: Association of American Railroads.

Exhibit 3: U.S. Class I Rail Network with Major Forced Access Regions Under the NITL Proposal



Source: William J. Rennie Testimony, Exhibit 7.

Exhibit 4: NITL Assertions for U.S. and Canadian Switching, 2007

	Total Switching Locations	Total Non-Intermodal Carloads	Carloads Switched
US/Canada	22/1	6/1	1/2.3
United States	1,500	19,094,000	120,000 <i>(NITL projected)</i>
Canada	67	3,095,000	279,900 <i>(actual)</i>

Source: NITL Opening Submission, op. cit., pp. 60-61. 2007 data used, as this is the basis of NITL's calculations. Numbers may not add due to rounding. The NITL projected impacted carloads for BNSF, CSX, NS, and UP only.

Exhibit 5: NITL Assumption of U.S. Carload Switching

	Assumed US Carload Impact
NITL Original Assumption	120,000
NITL Assumption W/ Corrected Total Carloads	1,726,700
Magnitude of Under-Statement	14x

Source: [Cite and refer to Exhibit V-4].

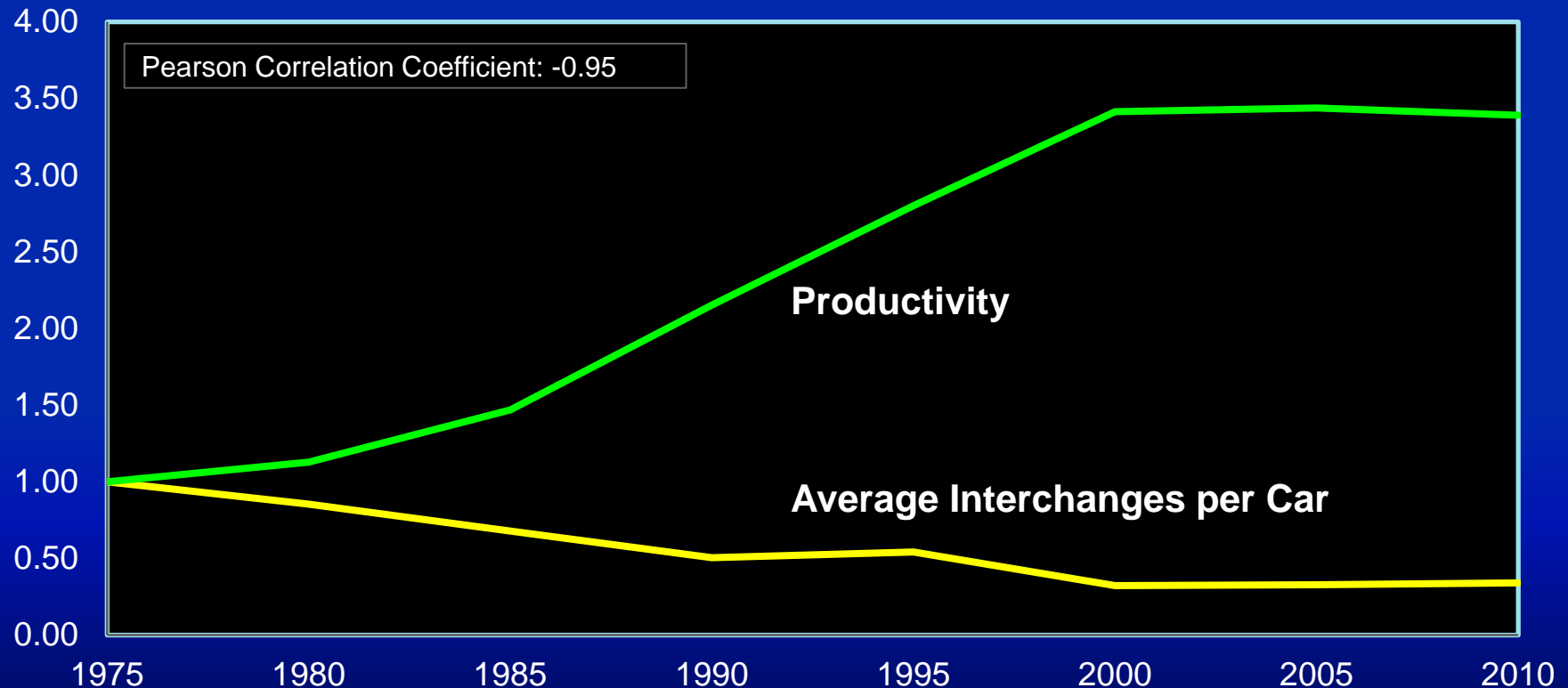
Testimony of William J. Rennie: Exhibits

March 25, 2014

**Before the Surface Transportation Board
In the Matter of Ex Parte No. 711,
Petition for Rulemaking to Adopt Revised
Competitive Switching Rules**

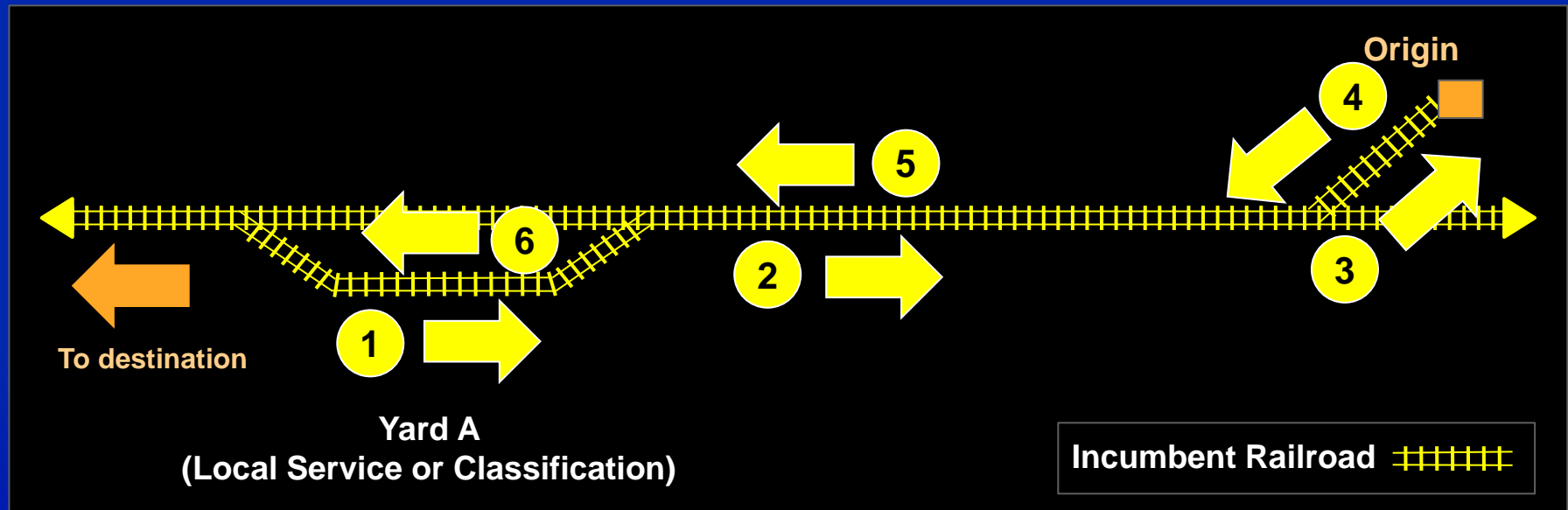
Exhibit 1: Indexed Average Interchanges per Railcar vs. Productivity, 1975-2010

Productivity = revenue ton-miles/\$ of inflation-adjusted operating expense



Source: Rail Fact Book, 2012 edition, Association of American Railroads, pp. 14 and 27 (opex and RTM); Association of American Railroads email (avg. interchanges); <ftp://ftp.bls.gov/pub/special.requests/cpi/cpiat.txt> (CPI); Oliver Wyman analysis. The correlation coefficient was generated from actual values, not indexed values

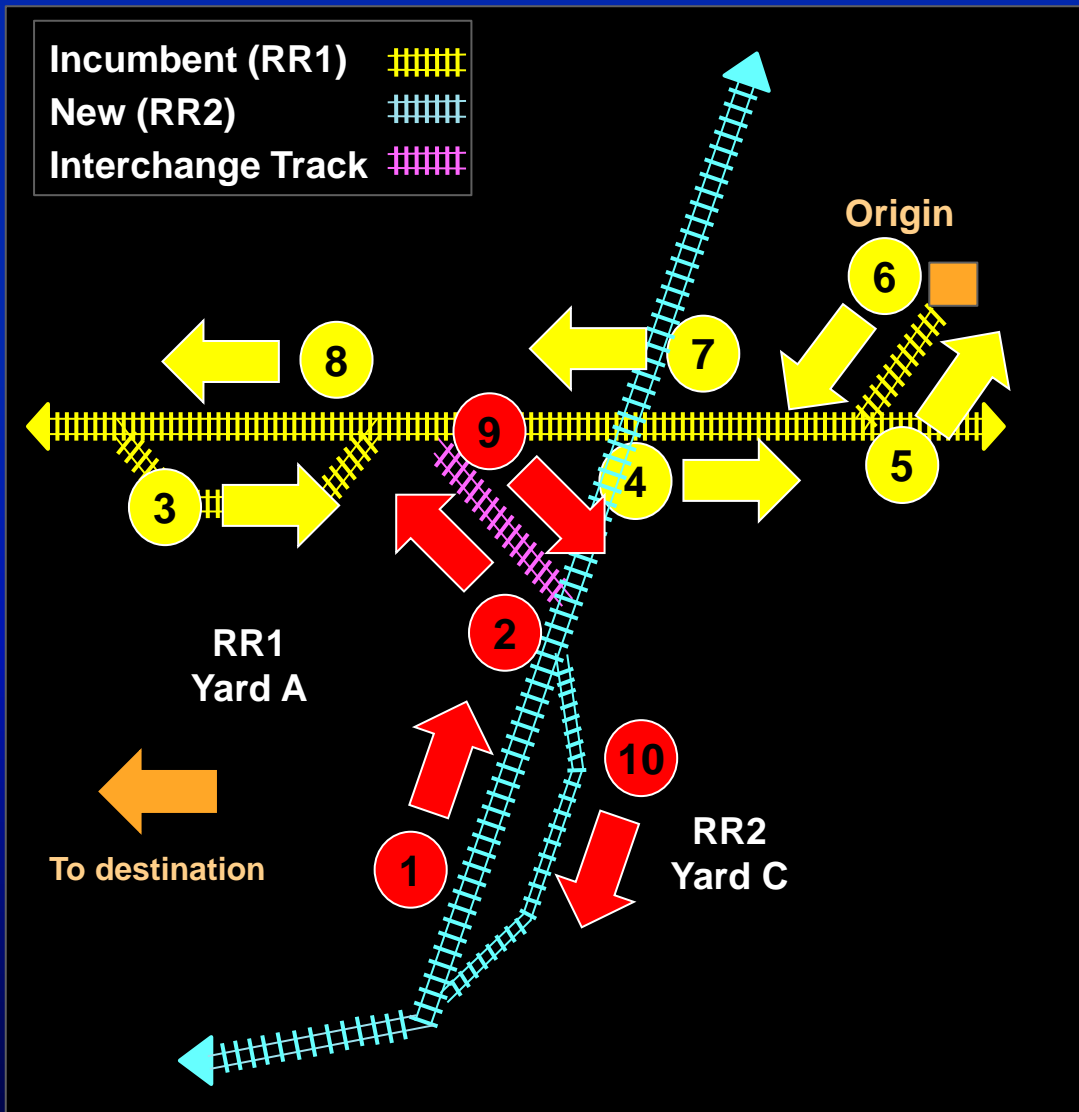
Exhibit 2: Single-Line Car Origination



Step	Description
1	Yard switch to move empty car to way train
2	Way train moves empty car to Consignor
3	Industry switch to spot empty car at Consignor for loading
4	Industry switch to retrieve loaded car from Consignor
5	Way train moves loaded car to yard
6	Yard switch of loaded car to outbound road train

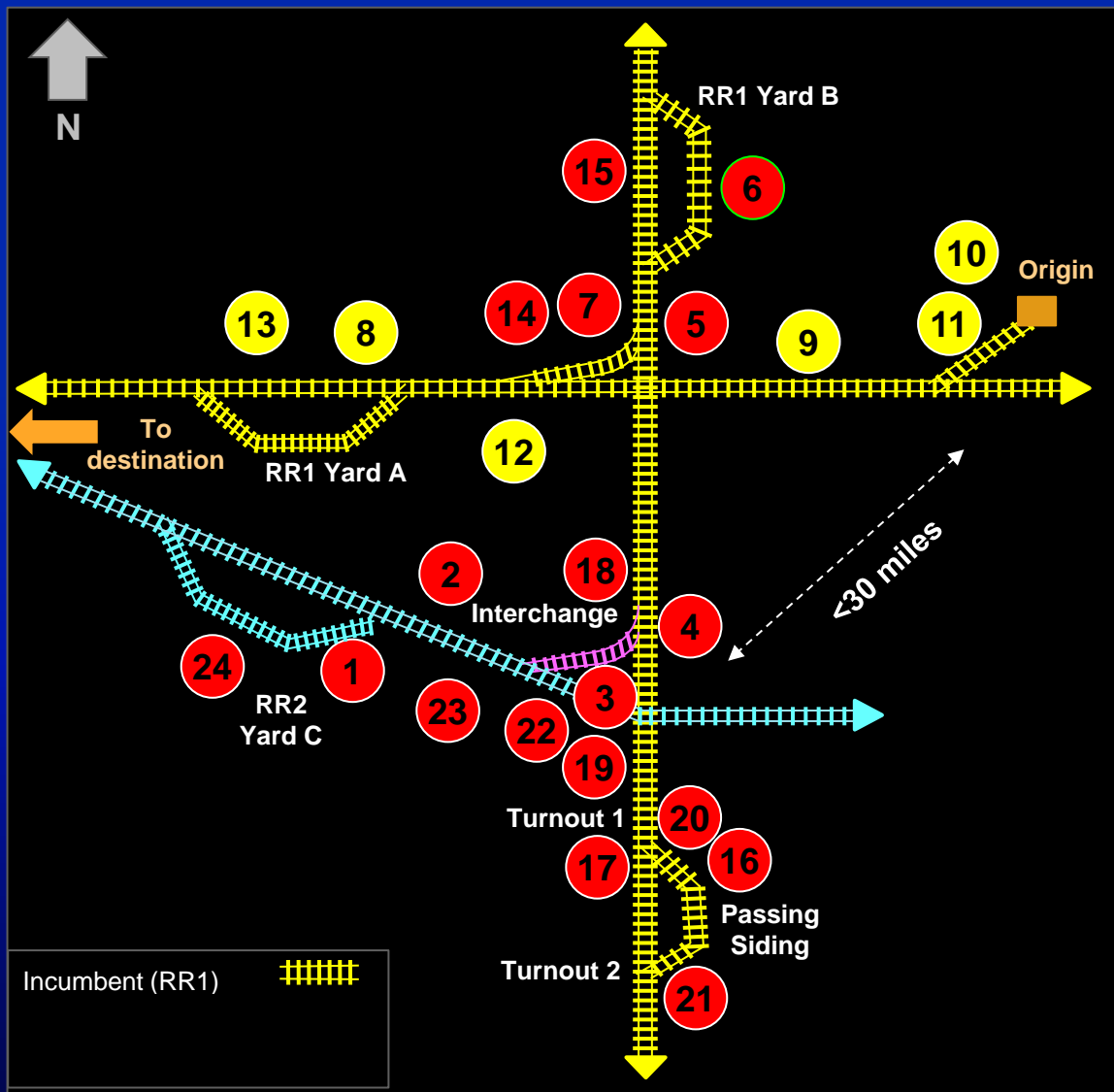
Exhibit 3: Several Additional Car Handlings Are Required for Even the Simplest Forced Switch

328



Step	Description
1	Yard switch Yard to move empty car to interchange train at Yard C
2	Interchange train moves empty car from Yard C to Yard A
3	Yard switch to move empty car to way train at Yard A
4	Way train moves empty car to Consignor
5	Industry switch to spot empty car at Consignor for loading
6	Industry switch to retrieve loaded car from Consignor
7	Local service way train moves loaded car to Yard A
8	Yard switch to move loaded car to interchange block at Yard A
9	Interchange train moves loaded car from Yard A to Yard C
10	Yard switch to move loaded car to outbound road train at Yard C

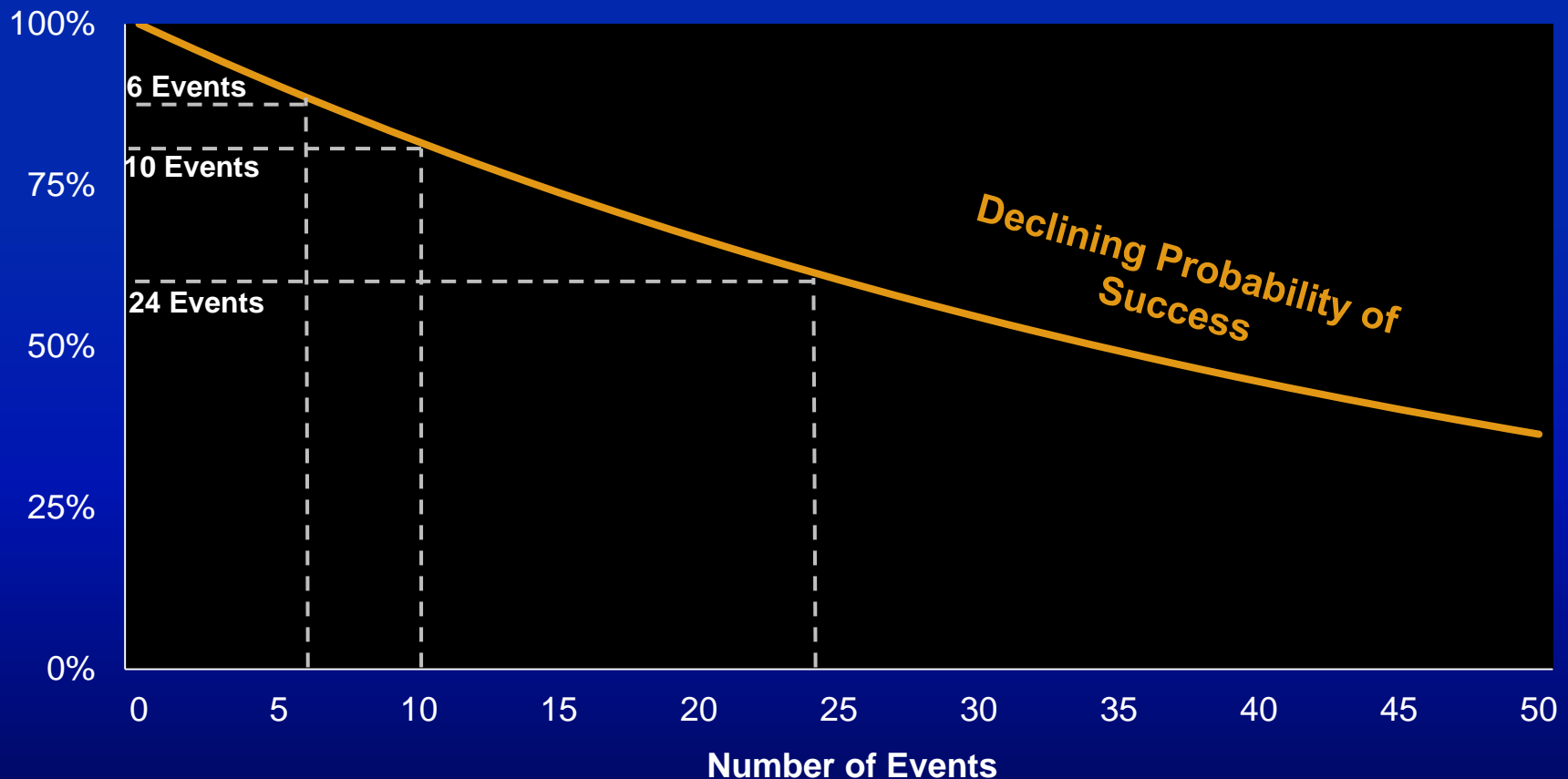
Exhibit 4: Many Forced Switches Will be Much More Complex



Step	Description	329
1	Yard switch to move empty car to way train at Yard C	
2	Way train moves empty car to interchange track	
3	Interchange switch to spot empty car on interch. track	
4	Interchange switch to retrieve empty car from interchange track	
5	Way train moves empty car to Yard B	
6	Yard switch to move empty car to way train serving Yard A	
7	Way train moves empty car via Connection to Yard A	
8	Yard switch to move empty car to way train serving Consignor	
9	Way train moves empty car to Consignor	
10	Industry switch to place empty car into Consignor's siding	
11	Industry switch to retrieve loaded car from Consignor's siding	
12	Way train moves loaded car to Yard A	
13	Yard switch to move loaded car to way train serving Yard B	
14	Way train moves loaded car to Yard B	
15	Yard switch to move loaded car to way train serving interchange	
16	Way train moves loaded car to passing siding	
17	Way train locomotive runs around train and couples to the end of the train	
18	Way train moves to clearance point beyond Interchange	
19	Interchange switch to spot loaded car on interch. track	
20	Way train backs to passing siding	
21	Way train locomotive runs around way train, couples to front and proceeds	
22	Interchange switch to retrieve loaded car from interchange track	
23	Way train moves loaded car to Yard C	
24	Yard switch to move loaded car into outbound road train	

Exhibit 5: The Probability of Successfully Executing a Trip Plan Decreases as the Number of Switch Events Increases

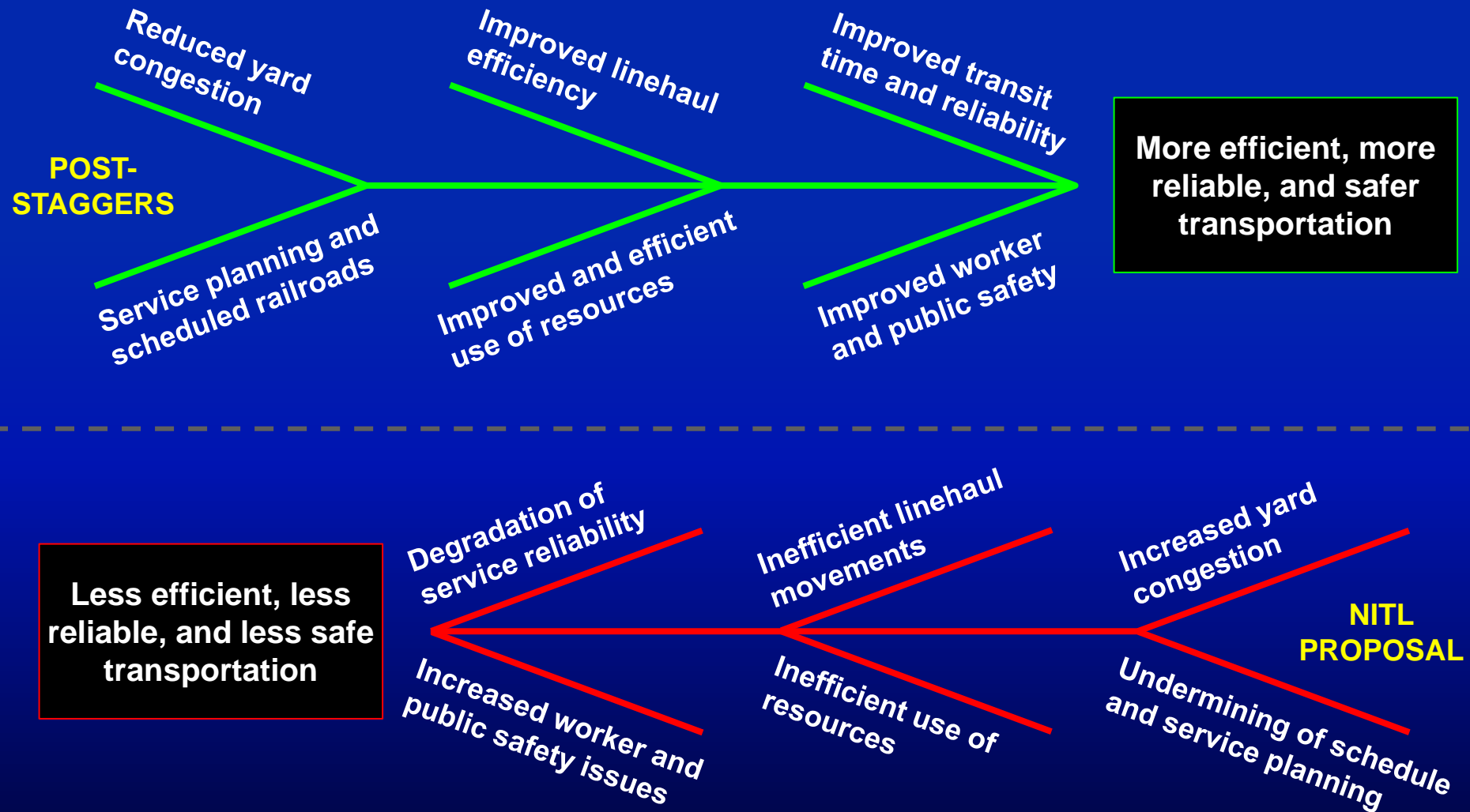
If probability of each individual event being successful = 98%



Note: A 98 percent probability of performing each individual switching event according to plan is above levels normally experienced by the Class I railroads. The probability of meeting a trip plan is equal to the probability of performing each individual switching event according to plan, raised to the power of the number of switching events.

Source: Oliver Wyman analysis.

Exhibit 6: Post-Staggers Improvements vs. Service Impacts of the NITL Proposal



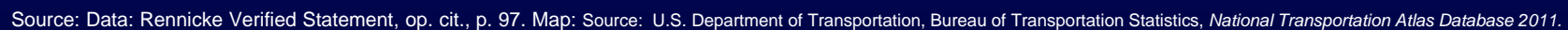
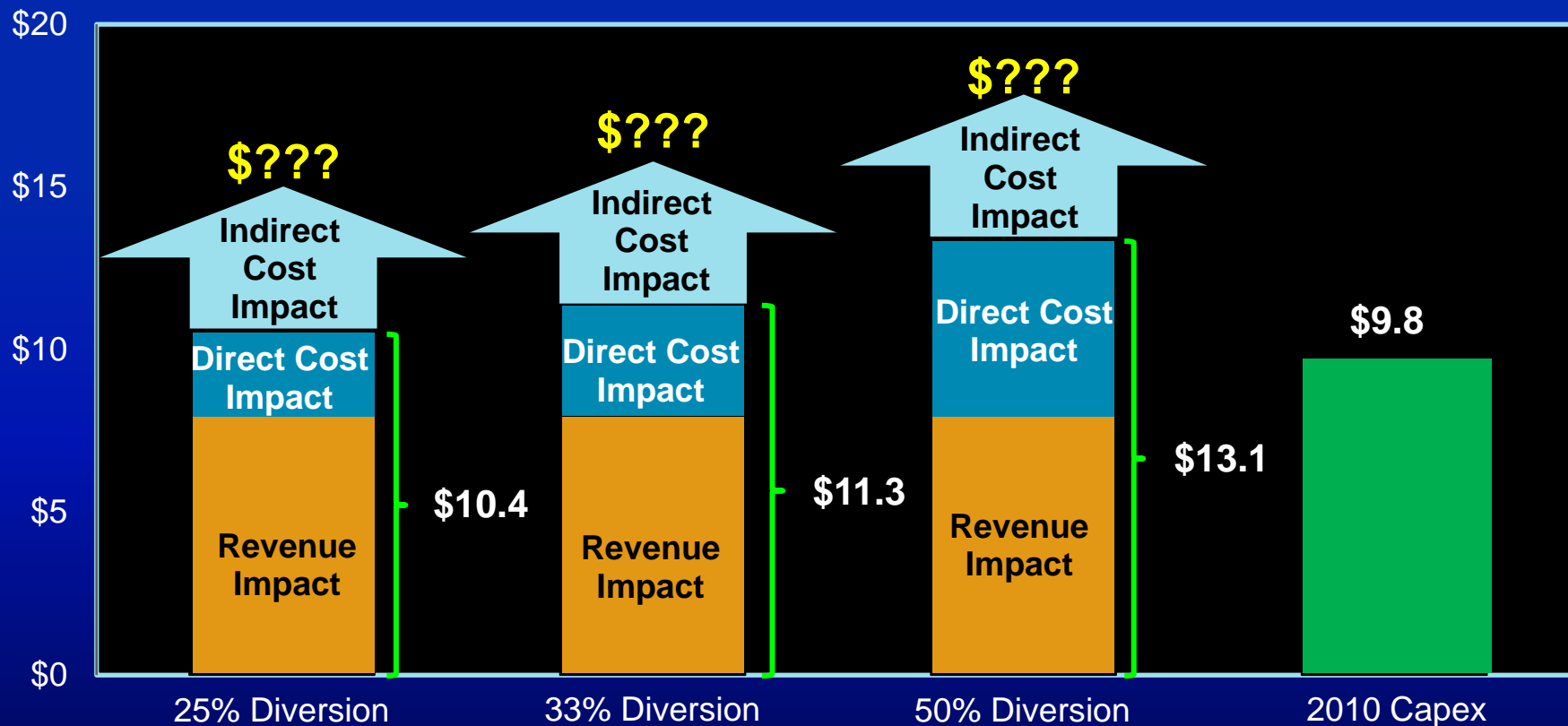


Exhibit 8: Potential Impacts of Mandated Switching Due to Revenue Loss and Increased Direct and Indirect Costs

\$ billions



Source: Revenue impacts based on Oliver Wyman analysis of the NITL and FTI data contained in the EP 711 filing, Uses the FTI projection of 7.5 million impacted carloads. March 1, 2013. 2010 capex is from Railroad Facts, 2011 edition, op. cit., p. 44.

Association of American Railroads

AAR's Key Points

- Vague and incomplete proposal
- Adverse effect on freight and passenger service
- Undermine future capacity investment
- No public benefits
- Canadian experience is irrelevant
- This proceeding should be terminated



Ex Parte 711 Public Hearing Charts for Michael R. Baranowski

Figure 1: Carload Estimates Developed from Non-Revenue and Revenue Screens

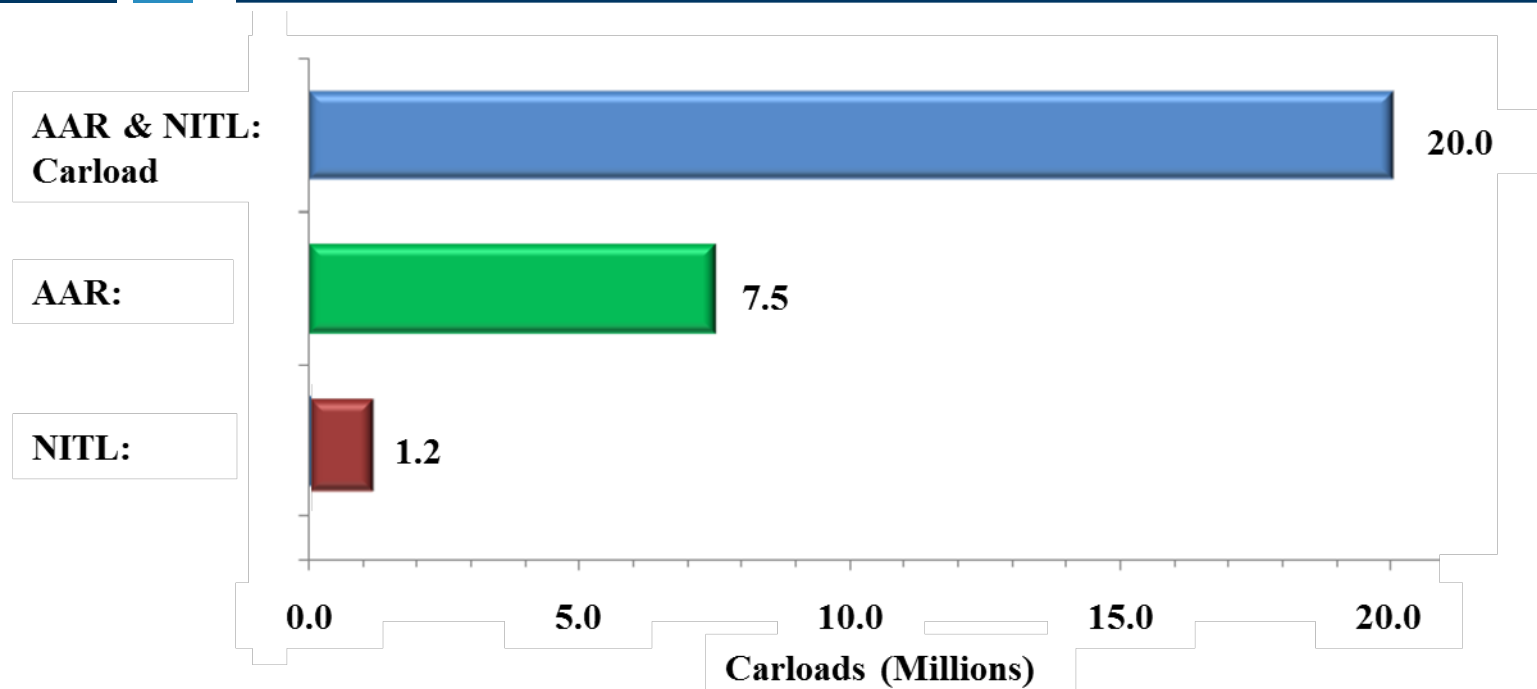
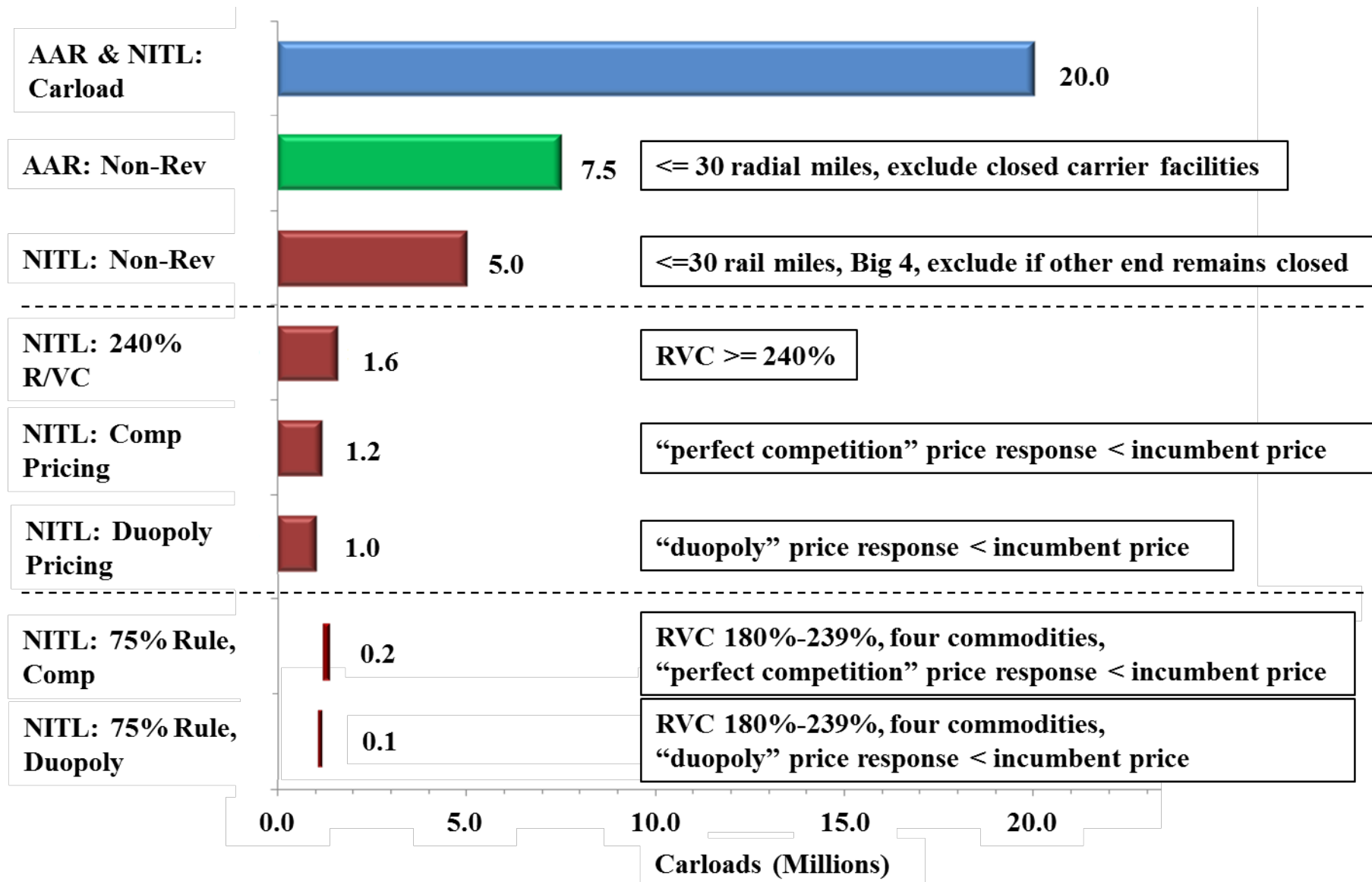


Figure 2: Carload Estimates Developed from Non-Revenue and Revenue Screens



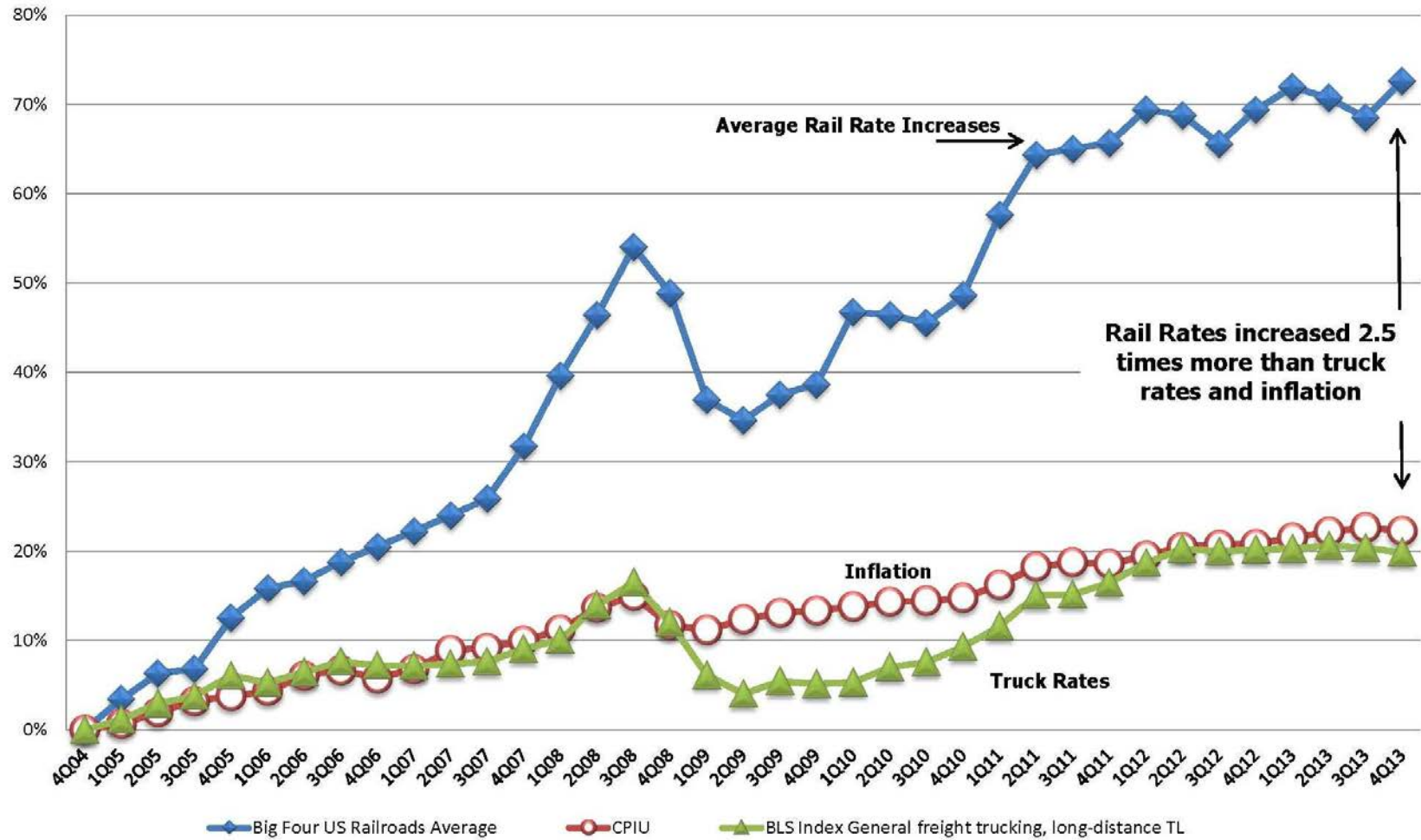
STB Ex Parte No. 711
*Petition for Rulemaking to Adopt
Revised Competitive Switching Rules*

Presentation of
The National Industrial
Transportation League
March 25, 2014

Witnesses

- Bruce Carlton, President, The National Industrial Transportation League
- Karyn Booth and Nicholas DiMichael, Thompson Hine LLP
- Jay Roman, President, Escalation Consultants
- Walter Schuchmann, Vice President, Operations Planning, R.L. Banks & Associates

Percent Change in Average Revenue Per Car on the Big Four U.S. Railroads versus the CPIU and the BLS Long Haul Trucking Index (4Q2004 - 4Q2013)



Source: Railroad's average revenue per car in each period is calculated from the railroad's SEC filings.

Overview of NITL Presentation

- NITL performed detailed analyses of the CSP
 - CSP is consistent with the Staggers Act
 - CSP impacts on shippers and carriers are balanced
 - CSP would inject a reasonable level of rail competition into the marketplace
 - CSP will **not** harm the railroads economically or operationally
- NITL analysis consistent with other credible CSP studies (e.g. USDOT, USDA, NG&FA)

Overview of NITL Presentation

- AAR analyses are incomplete and misleading
- AAR analyses are based on faulty assumptions which drastically overstate CSP impacts
- Record supports action by STB to initiate a rulemaking on competitive switching
- Competitive switching would benefit the public interest

The Board Has Broad Powers to Adopt New Competitive Switching Rules

- Statute seeks to encourage competitive switching
 - authorizes competitive switching when “practical and in the public interest” OR when “necessary to provide competitive rail service”
- Existing rules are unworkable
 - competitive switching has never been granted under the 1985 rules, and no shipper has even tried for over 15 years.
- Board has broad discretion to adopt new rules
- Changes in railroad market since 1985 support adoption of new rules

STB Question #1: Existing Terminals and Shippers

- Switching arrangements exist today:
 - All major RRs, where RRs have agreed
 - But, many shippers are excluded
- Existing switch fees in RR tariffs:
 - In the West, generally \$200-\$300 per car
 - In the East, generally \$400-\$500 per car
- CSP would expand on existing practice
- AAR provided no information on existing switching arrangements

STB Question #2: Carloads/Revenue Subject to Switching under CSP

- NITL Approach
 - Calculated the effect of both the 240% R/VC presumption and 75% market share presumption
 - Like DOT, focused on 240% R/VC presumption
 - Developed assumed access pricing methodology
 - Took into account all factors necessary for identifying impacted carloads and dollars
 - Calculated answers for all the questions asked by the Board
- This yields the total carloads & revenue potentially impacted by the CSP

NITL's Assumed Access Pricing Methodology

- An assumed pricing method is required to estimate the number of cars potentially impacted and the revenue effect
- NITL's assumed fee based on Canadian interswitching fee (determined by CTA)
- NITL assumed switch fees:
 - \$300 per car for switches of < 60 cars
 - \$89 per car for switches of 60 cars or more

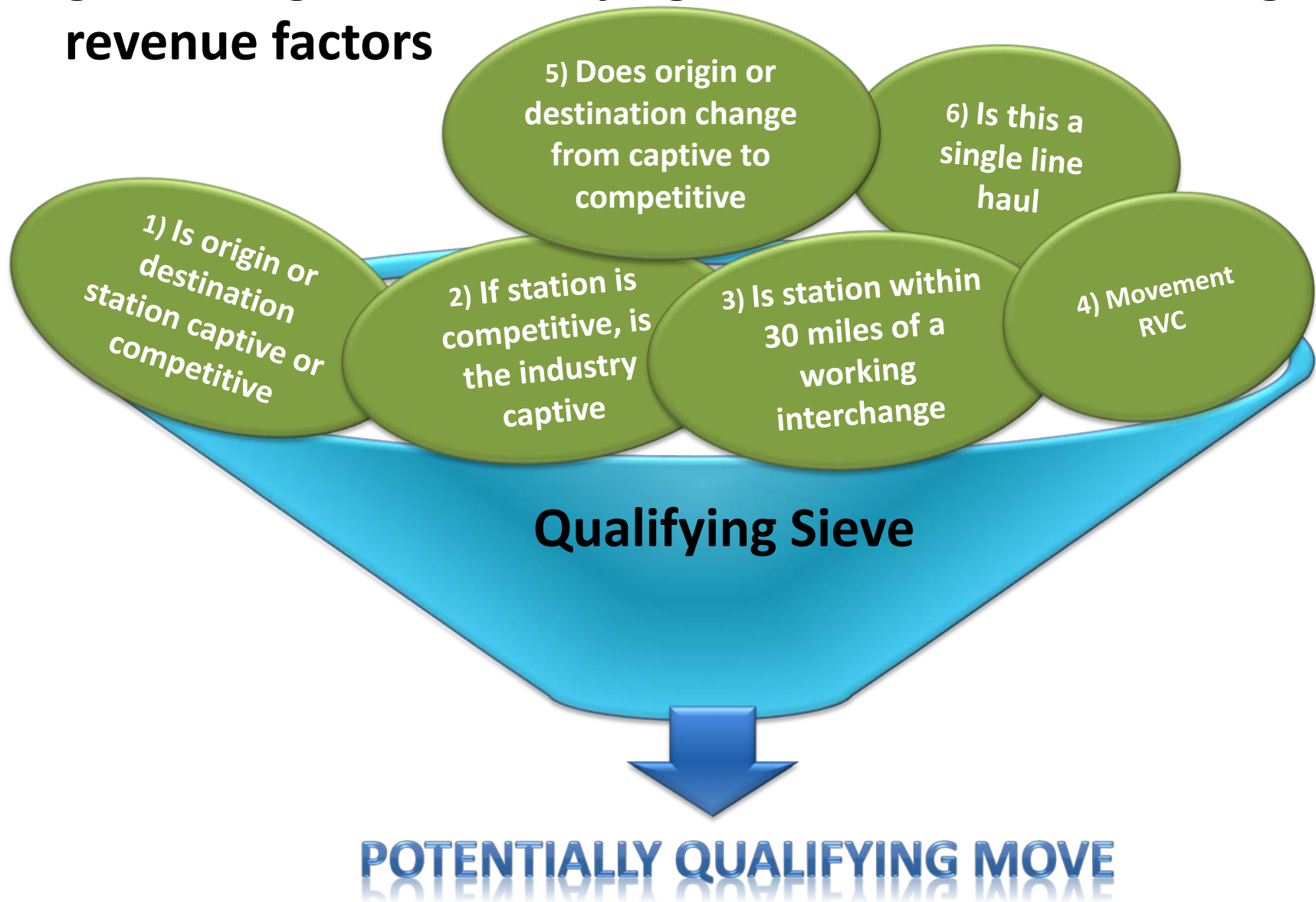
NITL Access Fee Consistent With Current³⁴⁸ Railroad Tariff Switching Charges

- BNSF and UP average switching fee is ~ \$250 per car
- NS and CSXT average switching fee is ~ \$400 per car
- AAR/railroads did not contest NITL's \$300 per car access fee
- AAR/railroads did not offer any access fee of their own

Impacted Carloads and Revenues: Non-Revenue and Revenue Factors

- A movement must satisfy CSP criteria to be eligible for competitive switching. These are the “non-revenue factors”
- NITL also examined “revenue factors” to determine potentially impacted movements
- The sum of movements that satisfy both factors provides the total number of carloads and revenue impacted by the CSP

Non-Revenue Factors – Movement factors that must get through the Qualifying Sieve before considering revenue factors ³⁵⁰



Impacted Carloads and Revenues:

Revenue Factors

- In addition to non-revenue factors or “sieves,” NITL examined each potentially eligible movement to determine if a competitive rate plus the assumed access price results in a rate lower than the shipper’s current rate
- This “revenue factor” establishes a separate “sieve” for determining the potentially impacted movements

Revenue Factors – How NITL Identified³⁵² Potentially Impacted Moves

	Impacted Move			Non-Impacted Move	
Existing Rate		\$4,000			\$3,000
Rate After CSP	\$3,100			\$3,100	
+ Access Fee	\$300			\$300	
Total Cost After CSP		\$3,400			\$3,400
Change in Rate		-\$600			\$400
Impacted Move?		Yes			No

“Full” vs. “Reduced” Competition Scenarios

- “Full Competition” scenario assumes that CSP results in a rate equal to the average “competitive” rate, for that carrier, commodity and mileage block
- “Reduced Competition” scenario assumes that CSP results in a rate higher than the average competitive rate
 - Not all forms of transportation competition apply to CSP traffic (only intramodal competition, in a concentrated rail market)
 - Competition muted because access fee must be paid

Results of NITL Analysis - Full Competition Scenario (carloads)

CSP Condition	Carloads (in millions)	Percent of All Rail Carloads ⁽¹⁾
240% RVC Condition	1.24	
75% of Traffic Condition	0.20	
Total Carloads	1.44	4.6%

⁽¹⁾ 31 million total carloads for BNSF, CSXT, NS and UP.

Results of NITL Analysis - Less Than Full³⁵⁵ Competition Scenario (carloads)

CSP Condition	Carloads (in millions)	Percent of All Rail Carloads ⁽¹⁾
240% RVC Condition	1.08	
75% of Traffic Condition	0.12	
Total Carloads	1.20	3.9%

⁽¹⁾ 31 million total carloads for BNSF, CSXT, NS and UP.

NITL Analysis Overstates CSP Impact

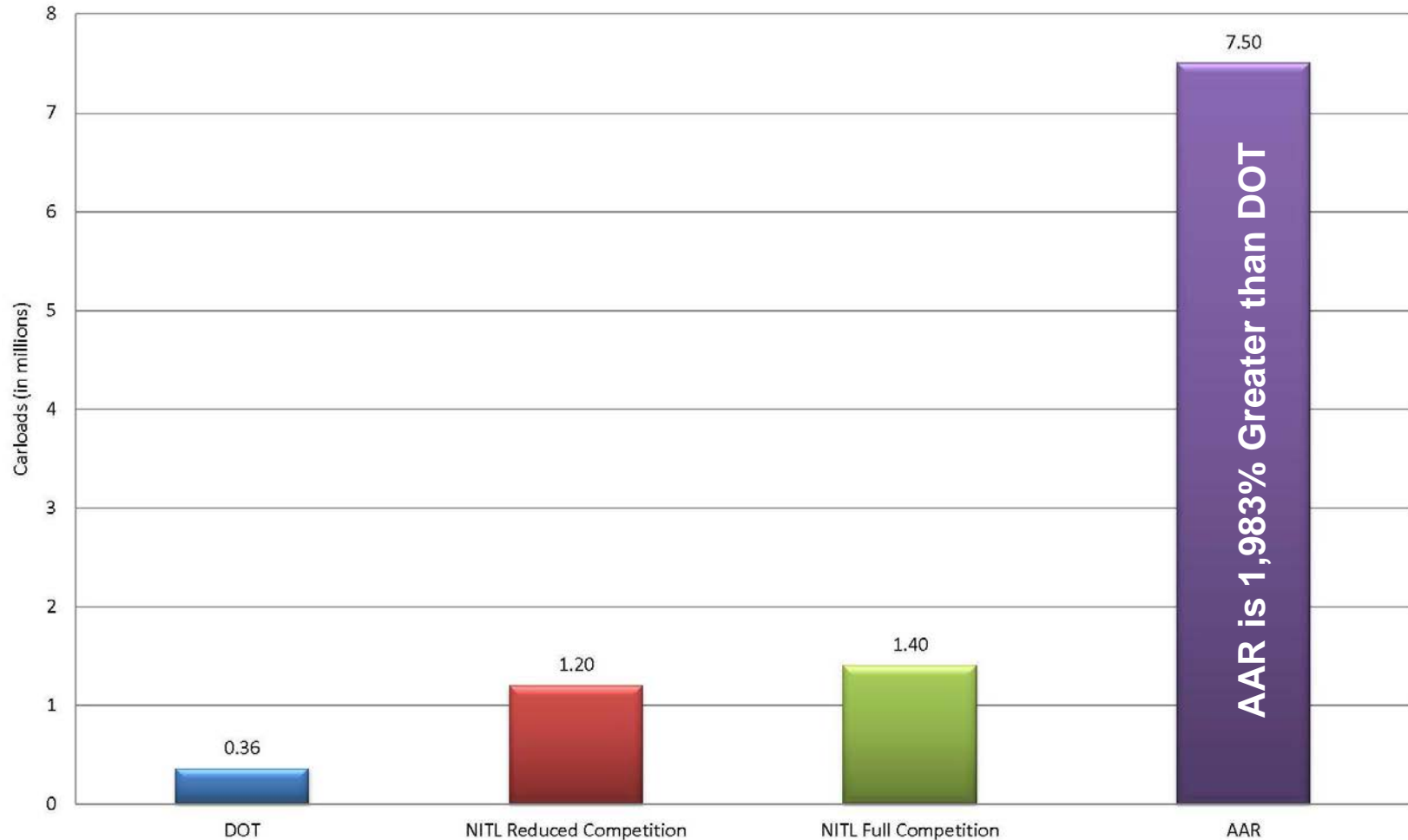
- NITL developed reasonable assumptions
- NITL analysis overstates the potential effect of the CSP:
 - Included all exempt traffic
 - Included all contract traffic
 - Ignored many paper barriers that would prevent many Class II and III carriers from competing
 - Assumed that all qualifying shippers applied for competitive switching

NITL Analysis Is Generally Consistent With DOT

- DOT focused on 240% presumption, as did NITL
- DOT focused on three major commodity groups (coal, chemicals and farm products)
- DOT found that 360,000 carloads of these commodities would be potentially impacted by the CSP
- This compares to NITL's estimate of 1.44 million carloads impacted, for all commodities

AAR Results Are Not Realistic

Ex Parte 711 Impacted Carload Results of NITL, DOT and AAR
(carloads in millions)



AAR's Estimate of Potentially Affected Carloads Is Overstated ³⁵⁹

- AAR's estimate of 7.5 million carloads affected is over 20 times DOT's estimate
- AAR only addressed the 75% market share presumption
- AAR admitted: "it is impossible to determine whether 75 percent of total traffic moves on the incumbent railroad" from the data
- AAR's "default assumption": RR that solely serves a station carries all traffic at that station is absurd
 - ignores the entire trucking, waterways and pipeline industries

NITL responded to all STB requests for empirical analysis to better understand the impact of Ex Parte 711, THE AAR DID NOT

Analysis	NITL	AAR
240% RVC and 75% Market share presumption	Yes	No
Potential access fee	Yes	No
Apply revenue factors	Yes	No
Identified captive shippers served by competitive stations	Yes	No
Results based on different mileage ranges	Yes	No
Results based on RSAM RVC's	Yes	No

STB Questions #3(a): How much would CSP Lower Rates/Reduce Railroad Revenue?

Full Competition Scenario

CSP Condition	Shipper Savings (in billions)	Percent of Big 4 Total Revenue ⁽¹⁾	Percent of Big 4 Net Revenue ⁽²⁾
240% RVC Condition	\$1.294		
75% of Traffic Condition	\$0.115		
Total Shipper Savings	\$1.408	2.6%	9.8%

(1) 2010 Total revenue for BNSF, CSXT, NS and UP is \$52.92 billion on the Waybill.

(2) 2010 Net Revenue Before Taxes as reported by the four major US railroads is \$14.3 billion.

STB Questions #3(a): How much would CSP Lower Rates/Reduce Railroad Revenue?

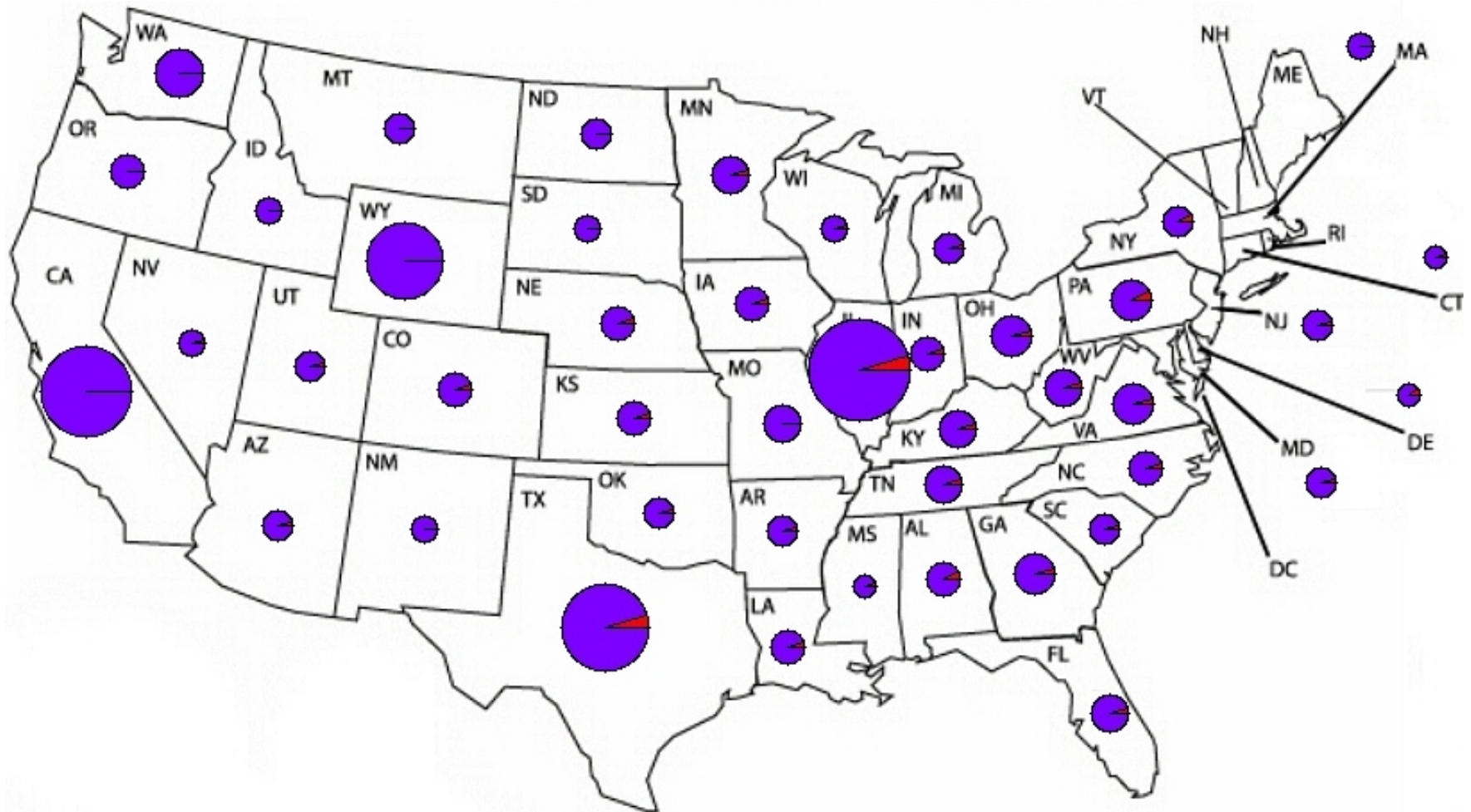
Less than Full Competition Scenario

CSP Condition	Shipper Savings (in billions)	Percent of Big 4 Total Revenue ⁽¹⁾	Percent of Big 4 Net Revenue ⁽²⁾
240% RVC Condition	\$0.908		
75% of Traffic Condition	\$0.038		
Total Shipper Savings	\$0.946	1.8%	6.6%

(1) 2010 Total Revenue for BNSF, CSXT, NS and UP is \$52.92 billion on the Waybill.

(2) 2010 Net Revenue Before Taxes as reported by the four major US railroads is \$14.3 billion

Impacted Revenue as Percent of Total Rail Revenue by State (Full Comp)



STB Question #4: Impact on Existing Captive Shippers

- Rates would not increase:
 - Union Pacific comments stated “UP believes widespread rate increases would be unlikely . . . UP already has every incentive to price traffic to maximize contribution.”
- No danger of regulatory effects:
 - SARRs not likely to be affected
 - Few captive shippers bring rate cases

STB Question #5: Effect of CSP on Rail Network Efficiency ³⁶⁵

- Key factors are:
 - (1) Number of cars potentially eligible for switching under the CSP
 - (2) Percent of eligible cars that are likely to actually switch carriers
 - (3) Ability of rail carriers to handle the traffic swing from one carrier to another

Number of Potentially Eligible Cars

- NITL's study results in a credible estimate of carloads potentially eligible for switching under the CSP (1.44 million)
 - AAR carload estimate is not credible
- This estimate is only a small fraction (4.6%) of the railroads' total traffic (31 million cars)

Number of Cars Likely To Be Switched

- NITL analyzed Canadian inter-switching data to estimate the number of cars that are likely to switch carriers
- Canadian experience indicates that only a small fraction (10% - 17%) of eligible carloads will actually switch carriers
- The incumbent is usually in the stronger competitive position

Number of Cars Likely to be Switched

- The estimated number of cars likely to be switched under the CSP is <250,000
- This is an extremely small percentage of the 5.4 million cars actually interchanged in 2010

Railroads Can Handle the Traffic Swings Expected Under the CSP

- Traffic patterns constantly change and railroads routinely deal with these changes
- Estimated <250,000 cars re-routed under CSP is much less than ordinary year-to-year swings in railroad traffic

Actual Year-to-Year Traffic Changes Far³⁷⁰ Exceed the CSP

U.S. Railroads – Carloads Originated			
Year	Total Carloads Originated	+ / - From Previous Year	% + / - From Previous Year
2011	30,000,000	790,000	2.7%
2010	29,210,000	3,204,652	12.3%
2009	26,005,348	(4,619,425)	(15.1%)
2008	30,624,773	(834,158)	(2.7%)
2007	31,458,931	(655,468)	(2.0%)
2006	32,114,399	972,182	3.1%
2005	31,142,217	1,047,421	3.5%

Source: AAR *Railroad Facts* and AAR website

Impacts Will Be Muted

- Traffic swings under CSP will take place gradually
- Many cars move in blocks
- CSP traffic takes place at existing interchanges: RR personnel, equipment and procedures are already in place
- RRs have modern routing tools
- Competition encourages efficiencies

Canadian Interswitching Provides A Reasonable Basis for Analyzing Impacts

- Regulated Interswitching in Canada has existed for decades
- A small fraction of eligible cars in Canada actually switch carriers
- No material impacts on operations or service
- RRs in Canada are highly profitable and have become more efficient and productive over time

AAR is Wrong that CSP Will Harm RR Networks – Carloads Overstated

- AAR relies on absurd estimate that 7.5 million carloads are eligible for switching under CSP
- AAR relies on an unsubstantiated estimate that 25% of eligible carloads will be diverted
- Applying AAR's est. 25% diversion percentage to NITL's est. of impacted cars (1.4 million) results only in diversion of <400,000 cars per year
- Impact of <400,000 cars is vastly smaller than AAR's diversion estimate of nearly 2 million cars

AAR is Wrong that CSP Will Harm RR Networks – Capabilities Understated

- AAR examples are highly speculative and do not estimate probability of occurrence
- AAR estimate of number of interchanges per carload is wrong
- RR productivity gains do not depend solely on reductions in interchanges and interchanges do not necessarily result in lost productivity
- RR have easily handled new interchanges in the past, *e.g.*, Conrail Shared Asset Areas, shortline spinoffs
- “America Has the Best Freight Rail System in the World” (AAR quote) and it will easily accommodate the modest impacts of CSP

Conclusions Regarding Effect of CSP on Rail Network Efficiency³⁷⁵

- The number of cars potentially eligible for the CSP is far smaller than RRs estimate
- Only a small number of cars are expected to “switch” to a new carrier (<250,000)
 - Less than usual swing in rail traffic year to year
- Railroads can easily handle the expected diversions
- NITL evidence is more credible

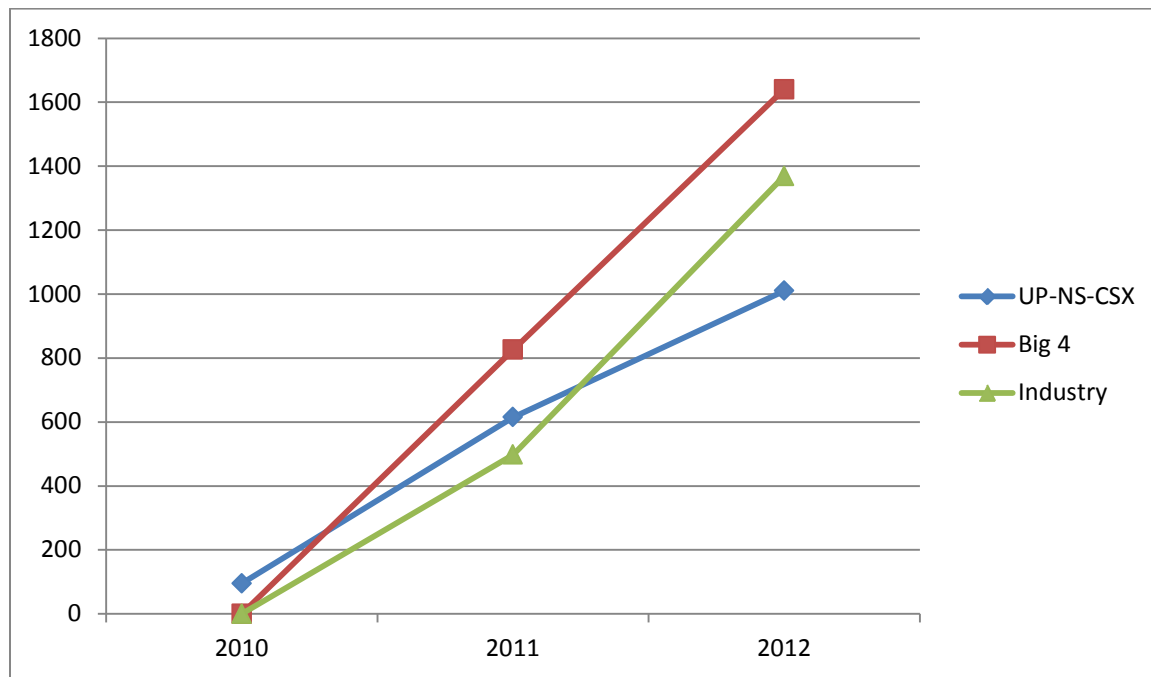
CSP Provides for Evaluation of Adverse³⁷⁶ Operational Impacts

- Under CSP, carrier can contest request for competitive switching
- Carrier must show that competitive switching:
 - would not be feasible
 - would be unsafe or
 - would unduly hamper the ability of the rail carrier to serve its own customers

Overall Conclusions

- Board's existing rules are unworkable and inconsistent with statutory purpose
- STB has broad discretion to adopt the CSP
- CSP is reasonable, balanced and narrowly-drawn to provide relief to captive shippers
- CSP would inject a reasonable amount of competition into system, without harming railroads
- Record strongly supports action by STB to promptly issue a NPR on the CSP

Supracompetitive Rail Earnings, 2010-2012 (\$ Millions)



Source: STB Docket No. EP 552 (Sub-Nos. 15, 16 and 17), Appendix B.

Surface Transportation Board
Ex Parte No. 711
Public Hearing on
Petition for Rulemaking To Adopt Revised
Competitive Switching Rules

U.S. Department of Transportation
March 25, 2014



Table 1: Data Set Development for Competitive Switching Analysis³⁸⁰

	Number of Records	Origin/Destination Pairs	Carloads Originated (millions)	Rail Revenues (billions)
A. Total Waybill	580,928	55,788	33.3	\$60.9
B. U.S Origins/Destinations (revenues & costs >0)	537,494	48,140	31.4	\$55.0
C. U.S Origins/Destinations (revenues & costs >0) excluding exempt traffic	126,519	15,537	5.9	\$11.5
D. U.S Origins/Destinations (revenues & costs >0); R/VC≥240; excluding exempt traffic	26,704	7,229	3.5	\$8.3
E. Class I single line moves-- U.S Origins/Destinations (revenues & costs >0); R/VC≥240; excluding exempt traffic	22,031	5,511	3.1	\$6.9
F. BNSF, UP, NS, CSXT single-line moves--U.S Origins/Destinations (revenues & costs >0); R/VC≥240; excluding exempt traffic	19,646	5,161	2.8	\$6.7



Chart 1: Revenues and Carloads for Traffic with $RVC \geq 240$ as a Percent of Total ³⁸¹
Revenues and Total Carloads for Four Examined Class I Railroads

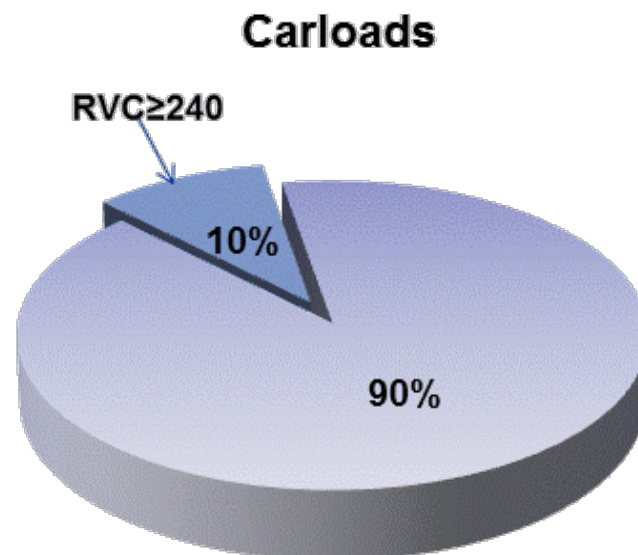
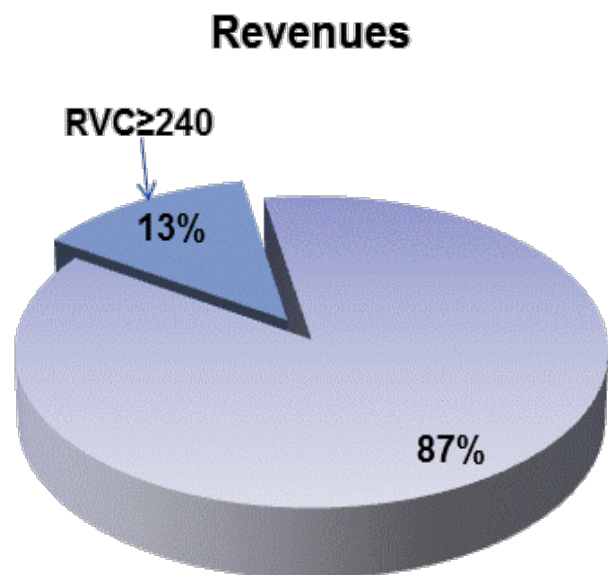


Table 2: Total Carload and Revenues by Commodity for R/VC \geq 240

Commodity	Carloads	% of Total R/VC \geq 240 Carloads	Revenues (\$ in millions)	% of Total R/VC \geq 240 Revenues
Coal	2,074,566	73.43%	\$4,190.29	62.74%
Chemical or Allied Products	343,121	12.14%	\$1,426.67	21.36%
Farm Products	163,280	5.78%	\$428.69	6.42%
Food or Kindred Products	52,504	1.86%	\$162.77	2.44%
Petroleum or Coal Products	58,125	2.06%	\$144.24	2.16%
Nonmetallic Minerals; except Fuels	27,789	0.98%	\$61.70	0.92%
Metallic Ores	47,989	1.70%	\$56.23	0.84%
Transportation Equipment	27,145	0.96%	\$45.07	0.67%
Electrical Machinery, Equipment or Supplies	1,212	0.04%	\$36.51	0.55%
Machinery; except Electrical	3,110	0.11%	\$31.33	0.47%
Clay, Concrete, Glass or Stone Products	9,492	0.34%	\$31.10	0.47%
Miscellaneous Freight Shipments	6,512	0.23%	\$24.96	0.37%
Hazardous Wastes	3,255	0.12%	\$15.56	0.23%
Waste or Scrap Materials Not Identified by Producing Industry	4,992	0.18%	\$12.76	0.19%
Ordinance or Accessories	1,344	0.05%	\$8.73	0.13%
Pulp, Paper or Allied Products	828	0.03%	\$2.19	0.03%
Crude Petroleum, Natural Gas or Gasoline	120	0.004%	\$0.30	0.004%
TOTAL R/VC\geq240	2,825,384	100%	\$6,679.1	100%



Table 3: Characteristics for the Three Examined Commodity Groups for the Four Examined Railroads 383

Commodity Description	Carloads	Revenues (\$ in millions)	Number of O/D Pairs
Coal	2,074,566	\$4,190.3	954
Chemical or Allied Products	343,121	\$1,426.7	2,489
Farm Products	163,280	\$428.7	532
Other	244,417	\$633.4	1,186
Sum	2,825,384	\$6,679.1	5,161



Table 4. Carloads, Revenues, and O/D Pairs Meeting R/VC \geq 240³⁸⁴ and 30-Mile Interchange Test

Railroad Commodity Totals	Carloads	Revenues (\$ in millions)	Number of O/D Pairs
Coal	105,152	142.62	34
Chemicals or Allied Products	182,904	772.95	1,416
Farm Products	72,086	170.73	199
Total	360,142	\$1,086.30	1,649



Chart 2: Railroad Revenues and Carloads Meeting NITL Proposal $R/VC \geq 240$ and 30-Mile Interchange Test

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